Supreme Court, U.S.
FILED

No. 03-1713 JUN 28 2004

In The
Supreme Court of the United States

NU-LOOK DESIGN, INC., and
JOSEPH M. GREY PUBLIC ACCOUNTANT, P.C., and
MIKE J. GRAHAM TRUCKING, INC., and
WATER-PURE SYSTEMS, INC., and
SUPERIOR PROSIDE, INC., and
SPECIALTY TRANSPORT & DELIVERY SERVICES, INC.,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

A P P E N D I X

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TABLE OF CONTENTS

Page

I. Petitioner: NU-LOOK DESIGN, INC.
(Pages: "-A")

CIRCUIT COURT OPINION..... 1a-A

JUDGMENT OF CIRCUIT COURT.....11.1a-A
(sought to be reviewed)

U.S. TAX COURT OPINION.....12a-A

U.S. TAX COURT DECISION.....32a-A

CIRCUIT COURT ORDER DENYING.....34a-A
PETITION FOR REHEARING EN BANC
(Dated: April 1, 2004)

II. 3 Petitioners: (Pages:"-BCD", "-B",
"-C", and "-D")

JOSEPH M. GREY PUBLIC
ACCOUNTANT, P.C. (Pages: "-B)

MIKE J. GRAHAM TRUCKING, Inc.
(Pages: "-C")

WATER-PURE SYSTEMS, INC.
(Pages: "-D")

CIRCUIT COURT OPINION.....36a-BCD
(3 Petitioners)(Pages: "-BCD")

JUDGMENT OF CIRCUIT COURT.....41a-BCD
(sought to be reviewed; Pages: "-BCD")
(Dated: April 7, 2004)

U.S. TAX COURT OPINION.....43a-B
(J.M. GREY PUB. ACCOUNTANT, P.C.)
(Pages: "-B")

U.S. TAX COURT DECISION.....61a-B
(J.M. GREY PUB. ACCOUNTANT, P.C.)
(Pages: "-B")

TABLE OF CONTENTS

(Continued)

Page

U.S. TAX COURT OPINION..... 63a-C
(MIKE J. GRAHAM TRUCKING, P.C.)
(Pages: "-C")

U.S. TAX COURT DECISION..... 80a-C
(MIKE J. GRAHAM TRUCKING, INC.)
(Pages: "-C")

U.S. TAX COURT OPINION.....82a-D
(WATER-PURE SYAYTEMS, INC.)
(Pages: "-D")

U.S. TAX COURT DECISION.....100a-D
(WATER-PURE SYSTEMS, INC.)
(Pages: "-D")

III. Petitioner: SUPERIOR PROSIDE, INC.
(Pages: "-E")

CIRCUIT COURT OPINION.....102a-E

JUDGMENT OF CIRCUIT COURT..... 106a-E
(sought to be reviewed)

U.S. TAX COURT OPINION.....108a-E

U.S. TAX COURT DECISION.....125a-E

CISCUIT COURT ORDER DENYING.....127a-E
PETITION FOR REHEARING EN BANC
(Dated: March 29, 2004)

IV. Petitioner: SPECIALTY TRANSPORT &
DELIVERY SERVICES, INC. (Pages: "-F")

CIRCUIT COURT OPINION.....128a-F

JUDGMENT OF CIRCUIT COURT.....135a-F
(sought to be reviewed)
(Date Issued in Liue of Formal
Mandate: May 13, 2004)

TABLE OF CONTENTS

(Continued)

	Page
U.S. TAX COURT OPINION	136a-F
U.S. TAX COURT DECISION	157a-F
V. PERTINENT PRORTIONS OF RELEVANT STATUTES	
A. Title 26 U.S.C. Sec. 1366(b)	159a
B. Title 26 U.S.C. Sec. 3121(d)	159a
C. Section 530 of the Revenue Act of 1978, as amended	159a
VI. OTHER AUTHORITIES:	
A. "Explanation of Provisions" section of H.R. Rep. No. 95-1748, 95th Cong., 2d Sess. 5 (1978) 1978-3 (Vol. 1) C.B. 631-633 (applying Sec. 530 of the Rev. Act of 1978)	163a
B. Unabridged Diction Definition of "or"	164a
C. 29 C.F.R. Sec. 2510.3-3(c)(1) (defining "employees")	164a

CORPORATE DISCLOSURE STATEMENT

The Petitioners, NU-LOOK DESIGN, INC., JOSEPH M. GREY PUBLIC ACCOUNTANT, P.C., WATER-PURE SYSTEMS, INC., MIKE J. GRAHAM TRUCKING, INC., SUPERIOR PROSIDE, INC. and SPECIALTY TRANSPORT & DELIVERY SERVICES, INC., are all corporations, incorporated in Pennsylvania.

Each of the above-named Petitioners is a nongovernmental corporate party to the proceedings and was a party to both the proceedings in the United States Tax Court ("Petitioner") and the U.S. Court of Appeals for the Third Circuit ("Appellant").

Each of the above-named Petitioners does not now have nor has ever had any parent or subsidiary corporation, and each of the above-named Petitioners is not now nor has ever been the parent or subsidiary corporation of another corporation.

No publicly held corporation nor any other corporation owns or ever has owned ten percent (10%) or more of the stock of any of the above-named Petitioners.

PRECEDENTIAL

Filed January 26, 2004

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 03-2754

NU-LOOK DESIGN, INC.,
Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

On Appeal from the United States Tax Court
(No. 01-10368)
Tax Judge: The Honorable Mary Ann Cohen

Submitted Under Third Circuit LAR 34.1(a)
January 9, 2004

Before: BARRY and SMITH, Circuit Judges,
and POLLAK, District Judge*

(Filed: January 26, 2004)

Joseph O'Donnell
116 East Allen Street
Philadelphia, PA 19125
Counsel for Appellant

---

*The Honorable Louis H. Pollak, Senior District Judge for the Eastern District of Pennsylvania, sitting by designation.

Regina S. Moriarty
Richard Farber
United States Department of Justice
Tax Division
P.O. Box 502 Washington, D.C. 20044
Counsel for Appellee

OPINION OF THE COURT

SMITH, Circuit Judge.

This appeal challenges the determination by the United States Tax Court that the Internal Revenue Service ("IRS") appropriately classified Ronald A. Stark, who was an officer and the sole shareholder of Nu-Look Design, Inc. ("Nu-Look"), as an employee of Nu-Look. That determination resulted in Nu-Look's liability for certain employment taxes under the Federal Insurance Contributions Act ("FICA") 26 U.S.C. Sec. 3101-3128, and the Federal Unemployment Tax Act ("FUTA") 26 U.S.C. Sec. 3301-3311. We affirm.

I.

On June 8, 2001, the IRS issued to Nu-Look a Notice of Determination Concerning Worker Classification Under Section 7436. The Notice advised that the IRS had classified an individual at Nu-Look as an employee for purposes of federal employment taxes and that such taxes "could" be assessed for calendar years 1996, 1997 and 1998. The Notice further advised that the IRS had determined that Nu-Look was "not entitled to relief from this classification pursuant to Section 530 of the Revenue Act of 1978." Although the Notice did not identify the "employee" by name, it was clear that the alleged employee was its sole shareholder and president, Ronald A. Stark.

Nu-Look challenged this determination by filing a petition for redetermination in the United States Tax Court which asserted that Nu-Look had "properly and correctly distributed its net income to Mr. Stark in each of the said years (1996, 1997 and 1998) at issue. . . ." On February 26, 2002, Nu-Look filed a motion seeking leave to file an amended petition for redetermination. The motion asserted that the IRS had not complied with Section 530 of the Revenue Act of 1978 because it had failed to furnish Nu-Look with written notice of Section 530's provisions. This omission, according to Nu-Look, "seriously violated [Nu-Look's] Constitutionally guaranteed due process. . . ." The motion to amend was granted. In an amended petition for redetermination, Nu-Look not only disputed the propriety of the determination that Stark was an employee, but also sought relief from that determination under Section 530 of the Revenue Act of 1978.

The parties filed a stipulation of facts in the Tax Court. The stipulation established that Nu-Look, a subchapter "S" corporation since 1987, "operated as a residential home improvement company, providing carpentry, siding installation and general residential home improvement and construction services to the public." During calendar years 1996, 1997 and 1998, Stark was not only Nu-Look's sole shareholder and president, but he also managed the company. He solicited business, performed necessary bookkeeping, otherwise handled finances, hired and supervised workers. Rather than pay Stark a salary or wages, Nu-Look distributed its net income during 1996, 1997 and 1998 to him "as Mr. Stark's needs arose. . . ." Nu-Look reported on its form 1120S tax returns in 1996, 1997 and 1998, a net income of $10,866.14, $14,216.37, and $7,103.60, respectively. Stark, in turn, reported the very

same amounts as non-passive income on Schedule E of his 1996, 1997 and 1998 Form 1040 tax returns.

In a decision dated February 26, 2003, the Tax Court found that Stark performed more than minor services for Nu-Look and that he had received remuneration for those services. As a result, the court held that Stark was an employee of Nu-Look and that Nu-Look was not entitled to relief under Section 530. Nu-Look filed this timely appeal.

II.

Section 7482(a)(1) of the Internal Revenue Code provides this court with "exclusive jurisdiction to review the decisions of the Tax Court. . .in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury. . . ." 26 U.S.C. Sec. 7482(a)(1). Accordingly, "we have plenary review of the Tax Court's findings of law, including its construction and application of the Internal Revenue Code." **PNC Bancorp, Inc. v. Comm'r of Internal Revenue.** 212 F.3d 822, 827 (3d Cir. 2000).

III.

Nu-Look contends that the Tax Court erred in determining that Stark was an employee under the FICA and the FUTA. We begin by looking to the statutory language. "Where the statutory language is plain and unambiguous, further inquiry is not required. . . ." **Idahoan Fresh v. Advantage Produce, Inc.**, 157 F.3d 197, 202 (3d Cir. 1998); see also **United States v. Gollapudi**, 130 F.3d 66, 70 (3d Cir. 1997)

Both the FICA and the FUTA impose taxes on employers based on the wages paid to individuals in their employ. 26 U.S.C. Secs. 3111, 3301. "Wages," as defined by both Acts, includes, with

certain exceptions not applicable here, "all remuneration for employment. . . ." 26 U.S.C. Secs. 3121(a), 3306(b). Employment is "any service of whatever nature, performed. . . by an employee for the person employing him. . ." 26 U.S.C. Secs. 3121(b), 3306(c). Employee is defined by the FICA as:

> (1) any officer of a corporation; or
>
> (2) any individual who, under the usual rules applicable in determining the employer-employee relationship, has the status of an employee[.]

26 U.S.C. Sec. 3121(d). Under the FUTA, the term employee, with certain exceptions not relevant here, has the same meaning as Sec. 3121(d) of the FICA. 26 U.S.C. Sec. 3306(i). The general rule that an officer of a corporation is an employee of that coporation is restated in Treasury Regulation Sec. 3121(d)-1(b). That regulation further specifies that there is an exception for an "officer of a corporation who as such does not perform any services or performs only minor services and who neither received nor is entitled to receive, directly or indirectly, any remuneration[.]" Treas. Reg. Sec. 3121(d)-1(b). The regulations promulgated pursuant to the FUTA are identical. Treas. Reg. 31.3306(i)-1(e).

Mindful of these statutory provisions and Stark's status as a corporate officer, the Tax Court appropriately focused on the nature of the services Stark rendered and whether the distributions Nu-Look paid were remuneration for those services. It found that Stark performed more than minor services and that the distributions Stark received were, in fact, remuneration for his services. Those findings led the Tax Court to conclude that Stark was an employee for purposes of the FICA and the FUTA.

We agree. The record establishes that Stark was a corporate officer and that he single-handedly managed Nu-Look's entire operation. The services that Stark rendered for Nu-Look were, therefore, substantial and the Tax Court appropriately concluded that Stark was an employee under Sec. 3121(d)(1). See **Spicer Accounting, Inc. v. United States**, 918 F.2d 90, 93 (9th Cir. 1990) (services provide by corporation's officer, who was the only certified public accountant performing services for the business, were substantial and dividends paid to him constituted remuneration); **Joseph Radtke, S.C. v. United States**, 895 F.2d 1196, 1197 (7th Cir. 1990) (concluding that dividends which were paid to lawyer, who was sole shareholder of subchapter S corporation and its only provider of legal services, were remuneration for services rendered and subject to the FICA and the FUTA).

Nu-Look argues, however, that Stark was not an employee under the usual common law rules applicable in determining employer-employee relationships and therefore was not an employee under Sec. 3121(d)(2). Nu-Look contends that, under Sec. 3121(d)(2), it must exercise specifice control over Stark for him to be classified as an employee and that such control was not demonstated because Stark himself managed Nu-Look's business affairs. This argument is withou merit because it completely ignores the plain language of Sec. 3121(d) and would render subparagraph (1) superfluous. Section 3121(d) defines employee by using the disjunctive "or" between subparagraphs (1) and (2). Thus, an individual' may qualify as an employee under each set of circumstances. Here, because Stark was a corporate officer, he came within Sec. 3121(d)(1) and the Tax Court was not required to consider whether he was an employee under the common law rules applicable under Sec.

3121(d)(2).

As support for its position that the common law rules for determining the existence of an employer-employee relationship govern the determination of whether Stark is an employee for federal employment tax purposes, Nu-Look relies on **Texas Carbonate Co. V. Phinney**, 307 F.2d 289, 291-92 (5th Cir. 1962). There, the Fifth Circuit considered whether Luther Miller, a corporate director, officer and shareholder of Texas Carbonate, was an employee for purposes of the FICA and the FUTA. The Court recognized that FICA's statutory definition of "employee" included corporate officers, but declared that the provision applied to "[o]nly such officers as work for it in fact" and that "in determining whether an officer is an employee within the meaning of the statutes the usual employer-employee tests are to be applied." 307 F.2d at 291-92. The Court's analysis focused on whether Miller's services, in the absence of any control by the corporation, were substantial. It pointed out that Miller did not perform services foe any other entity, was in charge of sales and marketing, and managed some of the company's affairs. These services, the Fifth Circuit concluded, were sufficient to establish that Miller was in fact an employee, thereby warranting the determination that the corporation was liable for federal employment taxes. Id. at 292-93.

Nu-Look's reliance on **Texas Carbonate** is puzzling. The analysis employed by the Fifth Circuit was substantively the same as the rule set forth in Treasury Regulations Sec. 3121(d)-1(b) and Sec. 3306(i)-1(e). Regardless, then, of whether the Tax Court applied the plain language of the statutory provisions or the **Texas Carbonate** test, Stark was an employee because of his status as a corporate officer who performed more than minor services. The Tax

Court did not err in concluding that Stark was Nu-Look's employee under Sec. 3121(d)(1).

IV.

Section 530 of the Revenue Act of 1978 provides a safe harbor for certain taxpayers who owe FICA and FUTA taxes as a result of wrogfully failing to classify certain individuals as employees. **303 West 42nd St. Enter., Inc v. I.R.S.**, 181 F.3d 272, 276 (2d Cir. 1999); Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (as amended by Act of Dec. 29, 1979, Pub. L. No. 96-167, 93 Stat. 1275; Act of Dec. 17, 1980, Pub. L. No. 96541, 94 Stat. 3204; Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324; Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085; Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755 (hereinafter cited as "Section 530"); see also **Springfield v. United States**, 88 F.3d 750, 751 n.2 (9th Cir. 1996) (discussing Section 530's legislative history). This uncodified section allows the taxpayer to avoid liability for certain federal employment taxes if the taxpayer had a "reasonable basis for not treating such individual as an employee." Section 530(a)(2); **303 West 42nd St. Enter., Inc.**, 181 F.3d at 274. A "reasonable basis" under this section of the Act may be established if the "taxpayer's treatment of such individual. . .was in reasonable reliance" upon

> (A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;
>
> (B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the

> individuals holding positions substantially similar to the position held by this individual; or
>
> (C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

Section 530(a)(2).

Here, Nu-Look asserts that the Tax Court erred in determining that it was not entitled to relief under this safe harbor provision. Citing **Texas Carbonate** as judicial precedent, 307 F.2d at 291-93, Nu-Look contends that it had a reasonable basis for not treating Stark as an employee.

This contention lacks merit. A reasonable reading of **Texas Carbonate** would not have provided Nu-Look with a basis to treat Stark as anything other than an employee. We find the Ninth Circuit's decision in **Spicer Accounting** instructive. 918 F.2d at 94-95. That Court rejected a taxpayer's argument that it was entitled to Section 530's safe harbor, explaining that Spicer, who was the corporation's sole shareholder and only certified public accountant providing services, was the "central worker for the taxpayer." It declared that a "corporation's sole full-time worker must be treated as an employee." 918 F.2d at 95.

V.

Nu-Look also argues that the IRS had committed a due process violation by failing to provide notice of Section 530's provisions (Foot Note 1: Section 530(e)(1) provides that the Internal Revenue Service "shall, before or at the commencement of any audit inquiry relating to the employment status of one or more individuals who perform services for the

taxpayer, provide the taxpayer with a written notice of the provisions of this section." Small Business Job Protection Act of 1996, Pub. L. No. 104-188, sec. 1122(a), 110 Stat. 1755, 1766 (1996).) The Tax Court rejected this argument, explaining that relief under the due process clause required some showing of prejudice. Such prejudice was absent, the Tax Court concluded, inasmuch as Nu-Look had been granted leave to amend its petition for redetermination so that it could seek relief under Section 530.

It is well established that an "elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." **Mullane v. Central Hanover Bank & Trust Co.**, 339 U.S. 306, 314 (1950); see also **Cleveland Bd. of Educ. v. Loudermill**, 470 U.S. 532, 542 (1985). Both of these requirements were met. The Notice of Determination specifically apprised Nu-Look that Stark had been classified as an employee and that relief under the safe harbor provision of Section 530 was not warranted. In addition, the Notice advised Nu-Look of the means by which it could challenge that determination. Accordingly, Nu-look is not entitled to relief under the due process clause.

VI.

In sum, we conclude that Stark was properly classified by the IRS as an employee of Nu-Look and that Nu-Look lacked a reasonable basis for failing to treat Stark as an employee. We will affirm the decision of the Tax Court that Nu-Look is liable for certain employment taxes under the FICA and the FUTA for calendar years 1996, 1997 and 1998.

A True Copy:
Teste:

Clerk of the United States Court
of Appeals for the Third Circuit

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Case No. 03-2754

NU-LOOK DESIGN, INC.,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

On Appeal From the United States Tax Court
(No. 01-10368)
Tax Judge: The Honorable Mary Ann Cohen

Submitted Under Third Circuit LAR 34.1(a)
January 9, 2004

Before: BARRY and SMITH, Circuit Judges,
and POLLAK, District Judge*

JUDGMENT

This cause came on to be heard on the record from the United States Tax Court and was submitted on January 9, 2004. On consideration thereof, it is now ORDERED and ADJUDGED that the decision of the Tax Court entered on March 10, 2003, be and the same hereby is AFFIRMED. All of the above in accordance with the opinion of this court.

*The Honorable Louis H. Pollak, Senior District Judge for the Eastern District of Pennsylvania, sitting by designation.

ATTEST:

/s/ Marcia M. Waldron

Marcia M. Waldron, Clerk

Dated: January 26, 2004

T.C. Memo. 2003-52

UNITED STATES TAX COURT

NU-LOOK DESIGN, INC., Petitioner v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 10368-01. Filed February 26, 2003.

Joseph H. O'Donnell, Jr., for petitioner.

Rubin W. Denick, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COHEN, Judge: The petition in this case was filed in response to a Notice of Determination Concerning Worker Classification Under Section 7436 (notice of determination) regarding petitioner's liabilities pursuant to the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) for 1996, 1997, and 1998. The issues for decision are: (1) Whether Ronald A. Stark (Stark) was an employee of petitioner for Federal employment tax purposes during 1996 through 1998 and, if so, (2) whether petitioner is entitled to relief under section 530 of the Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2885, as amended (Section 530).

Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure. For convenience, FICA and FUTA taxes are collectively referred to as employment taxes.

FINDINGS OF FACT

Some of the facts were deemed stipulated pursuant to Rule 91(f); certain additional facts

have been stipulated by the parties. The stipulated facts are incorporated in our findings by this reference.

Petitioner's Organization and Operations

Stark has been in the home improvement business since 1963. After operating his business as a sole proprietorship from 1963 through 1986, Stark decided to incorporate for the purposes of obtaining the benefits of limited shareholder liability for debts of the corporation. Petitioner was incorporated in Pennsylvania on January 20, 1987, and has at all relevant times operated as an S corporation. Petitioner's principal place of business was located in New Hope, Pennsylvania, at the address of Stark's personal residence, when the petition was filed in this case.

Since its organization, petitioner has operated as a residential home improvement company, providing carpentry, siding installation, and general residential home improvement and construction services to the public. This activity was and is petitioner's only business and only source of income. Stark has been the sole shareholder of petitioner from the time of its incorporation and throughout 1996, 1997, and 1998.

Stark has at all times served as petitioner's president and only officer. Minutes from petitioner's annual meetings of directors and shareholders reflect that, for each of the years in issue, Stark was elected president, vice president, secretary, and treasurer. Stark was also petitioner's sole director. During 1996, 1997, and 1998, Stark performed the following services for petitioner: (1) Solicited business on behalf of petitioner; (2) ordered petitioner's supplies; (3) entered into verbal and/or written agreements on behalf of petitioner; (4) oversaw the finances of petitioner; (5) collected moneys owed

petitioner; (6) managed petitioner; (7) supervised work performed on behalf of petitioner; (8) acquired customers for petitioner; (9) performed all bookkeeping services for petitioner; (10) made all hiring decisions and paid all individuals who performed services in connection with petitioner's residential home improvement business. Stark controlled the day-to-day activities of petitioner.

During 1996, 1997, and 1998, all moneys that were paid on accounts receivable of petitioner were deposited into petitioner's checking account. Stark was the only person with signature authority on petitioner's account. Petitioner did not make regular payments at fixed times to Stark for his services. Rather, Stark obtained funds from petitioner's bank account to pay himself as his needs arose. Petitioner neither classified any payment as a dividend nor distributed any dividends to shareholders from 1996 through 1998.

Petitioner's Tax Reporting

Petitioner filed forms 1120S, U.S. Income Tax Returns for an S corporation, and related schedules, for 1987 through 1995. On those returns, petitioner did not report treating Stark, or any other individual, as an employee of petitioner.

Petitioner filed form 1120S for each of the years 1996, 1997, and 1998. Petitioner reported ordinary income from its trade or business of $10,866.14, $14,216.37, and $7,103.60 for 1996, 1997, and 1998, respectively. Petitioner claimed no deduction either for compensation of officers or for salaries and wages. Schedules K-1, Shareholder's Share of Income, Credits, Deductions, etc., attached to the returns show $10,866.14 for 1996, $14,216.37 for 1997, and $7,103.60 for 1998 as the pro rata share of, and

as a property distribution other than a dividend, to Stark. Petitioner's Forms 1120S were signed by Stark as president and by Joseph M. Grey (Grey) as preparer.

During the period from 1996 to 1998, petitioner did not issue any Forms 1099-MISC, Miscellaneous Income, or Forms W-2, Wage and Tax Statement, to Stark. Throughout the years in issue, petitioner did not report paying Stark a salary or wages for work he performed on behalf of petitioner. Petitioner did issue separate Forms 1099-MISC in 1996, 1997, and 1998 reporting nonemployee compensation to a number of individuals other than Stark, presumably independent contractors hired to perform various aspects of petitioner's remodeling work.

Petitioner did not file a Form 941, Employer's Quarterly Federal Tax Return, for any quarter in 1996, 1997, or 1998 or a Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 1996, 1997, or 1998.

Stark's Tax Reporting

For each of the years, 1996, 1997, and 1998, petitioner timely filed a Form 1040, U.S. Individual Income Tax Return. On these returns, Stark reported as ordinary income from "Rental real estate, royalties, partnerships, S corporations, trusts, etc." $10,866.14, $14,216.37, and $7,103.60 for 1996, 1997, and 1998, respectively. Attached Schedules E, Supplemental Income and loss, characterize the foregoing amounts as nonpassive income from Schedules K-1.

The Notice of Determination

Prior to the audit underlying the instant case covering 1996, 1997, and 1998, respondent neither audited petitioner for employment tax purposes nor challenged petitioner's treatment of Stark as other than an employee. Thereafter,

on June 8, 2001, respondent sent to petitioner the notice of determination at issue in this proceeding. The notice was based on a determination that Stark was to be legally classified as an employee for purposes of Federal employment taxes and that petitioner was not entitled to relief from such classification pursuant to Section 530. Enclosed with the notice was a schedule setting forth petitioner's liabilities for FICA and FUTA taxes.

It is stipulated that, if the Court decides that Stark is to be classified as an employee for Federal employment tax purposes for all periods in 1996, 1997, and 1998, the amounts of taxes due and owing are as set forth in the notice of determination. Conversely, if the Court decides that Stark should not be classified as an employee for any of the periods in issue, the parties agree that petitioner owes no employment taxes.

ULTIMATE FINDINGS OF FACT

Stark, as president of petitioner, performed more than minor services and received remuneration therefor.

Petitioner did not have a reasonable basis for failing to treat Stark as an employee during the years in issue.

OPINION

I. Statutory and Regulatory Provisions

A. Subtitle C of the Internal Revenue Code

Subtitle C of the Internal Revenue Code governs payment of employment taxes. In particular, sections 3111 and 3301 impose taxes on employers under FICA (pertaining to Social Security) and FUTA (pertaining to unemployment), respectively, based on wages paid to employees. The term "wages" as used in these statutes

generally encompasses "all remuneration for employment". Secs. 3121(a), 3306(b). "Employee" is defined for purposes of FICA taxes in section 3121(d), and, with modifications not germaine here, section 3306)i) makes this definition applicable for purposes of FUTA taxes as well. Section 3121(d) provides:

> SEC. 3121(d). Employee. -- For purposes of this chapter, the term "employee" means --
>
> (1) any officer of a corporation; or
>
> (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or
>
> (3) any individual (other than an individualwho is an employee under paragraph (1) or (2) who performs services for remuneration for any person --
>
> (A) as an agent-driver or commission-driver * * *;
>
> (B) as a full-time insurance salesman;
>
> (C) as a home worker * * *; or
>
> (D) as a traveling or city salesman * * *;
>
> * * * [under specified conditions]; or
>
> (4) any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

Regulations promulgated under section 3121(d) clarify the scope of the inclusion in paragraph (1) for corporate officers, as follows:

> Generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does

> not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is considered not to be an employee of the corporation. * * * [Sec. 31.3121(d)-1(b), Employment Tax Regs.]

Identical language is also included in regulations promulgated under section 3306. Sec. 31.3306(i)-1(e), Employment Tax Regs.

B. Section 530 of the Revenue Act of 1978

Section 530 operates in enumerated circumstances to afford relief from employment tax liability, notwithstanding the actual relationship between the taxpayer and the individual performing services. The statute provides, in part:

> SEC. 530. CONTROVERSIES INVOLVING WHETHER INDIVIDUALS ARE EMPLOYEES FOR PURPOSES OF THE EMPLOYMENT TAXES.
>
> (a) Termination of Certain Employment Tax Liability. --
>
> (1) In general. -- If--
>
> (A) for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and
>
> (B) in the case of periods after December 31, 1978, all Federal tax returns (including informationreturns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such

individual as an employee.

(2) Statutory standards providing one method of satisfying the requirements of paragraph (1). -- For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

(A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

(B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

In specified circumstances, Section 530(e)(4) places the burden of proof on the Commissioner with respect to certain issues under Section 530, but this provision does not affect our analysis here. Section 530(e)(4) applies only to periods after December 31, 1996, so has no bearing on petitioner's liabilities for 1996. Small Business Job Protection Act of 1996, Pub. L. 104-188, sec. 1122(b)(3), 110 Stat. 1767. For subsequent periods, a taxpayer desiring to take advantage of Section 530(e)(4) first must establish a prima facie case that it was reasonable not to treat an individual as an employee and must have fully cooperated with the Secretary. Because, as explained in detail

below, petitioner did not establish a prima facie case that its treatment of Stark was reasonable, the burden of proof remains on petitioner with respect to 1997 and 1998 as well.

II. Classification of Stark for Employment Tax Purposes

A. Status Under FICA and FUTA Provisions

In contending that Stark should not be classified as an employee under the FICA and FUTA provisions of the Internal Revenue Code, petitioner focuses on Stark's status as an S corporation shareholder and alleged lack of status as a common law employee. We briefly address these contentions seriatim.

1. Contentions Regarding S Corporation Shareholders

Petitioner cites sections 1366, 1372, and 6037(c) and **Durando v. United States**, 70 F.3d 548 (9th Cir. 1995), presumably in support of an argument that S corporation shareholders should not be deemed employees. Sections 1366 and 6037(c) generally require that income items of S corporations be passed through to shareholders on a pro rata basis and reported by such shareholders in a manner consistent with treatment on the corporate return. These rules pertain to calculation of income tax liability under subtitle A and have no bearing on computation of Federal employment taxes. **Veterinary Surgical Consultants, P.C. v. Commissioner**, 117 T.C. 141, 145 (2001), affd. sub nom. **Yeagle Drywall Co. v. Commissioner**, 54 Fed. Appx. 100 (3d Cir. 2002). Furthermore, an employer cannot by the expedient of characterizing moneys paid in remuneration for services as distributions of net income, rather than as wages, avoid FICA and

FUTA liabilities. Id. at 145-146. Thus, as in **Veterinary Surgical Consultants, P.C. v. Commissioner**, supra at 145-146, and **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. 121, 128 (2002), we reject any suggestion that petitioner's passing through of its net income to Stark precludes the finding of an employer-employee relationship between petitioner and Stark. We likewise reject as not germaine to the question before us petitioner's reliance on section 1372, addressing fringe benefits under subtitle A, and the reference to that statute in **Durando v. United States**, supra at 551. See **Veterinary Surgical Consultants, P.C. v. Commissioner, supra** at 147-148, 150.

2. Contentions Regarding Common Law Employment

Petitioner contends that "employee" as used throughout section 3121(d) must be construed in a manner consistent with its use in section 3121(d)(2), such that the usual common law rules for determining existence of an employer-employee relationship are to be taken into account. In support of this position, petitioner quotes the following passage from **Tex. Carbonate Co. v. Phinney**, 307 F.2d 289, 291-292 (5th Cir. 1962):

> The statutory definition of "employees" as including officers of a corporation will not be so construed as to mean that an officer is an employee per se. Only such officers as work for it in fact are to be so included and, in determining whether an officer is an employee within the meaning of the statutes the usual employer-employee tests are to be applied. * * *

Petitioner further emphasizes that common law focuses on whether the alleged employer held the right to control the details of the work performed by the individual and argues that petitioner had neither the authority nor the ability to exert control over Stark. There exist, however, at least two fatal defects in petitioner's arguments in this regard.

First, from the standpoint of statutory construction, the premise underlying petitioner's position finds no support either in the structure of the text or in the **Tex. Carbonate Co. v. Phinney, supra**, decision. Section 3121(d) is written in the disjunctive, with each of the four paragraphs expressly separated from the next by "or". Accordingly, each paragraph affords a separate and independent basis for deeming one engaged to perform services for an employer. Individuals described in paragraph (1), (3), and (4) of section 3121(d) are therefore frequently referred to as "statutory" employees, subject to FICA and FUTA regardless of their status under common law. See **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner, supra** at 126.

Moreover, **Tex. Carbonate Co. v. Phinney, supra**, is not authority to the contrary. Significant regulatory and statutory developments have occurred since the years in issue in that case. Given that sections 31.3121(d)-1(b) and 31.3306(i)-1(e), employment tax Regs., were promulgated after those years and that the FUTA definition of "employee" then in effect appears to have contemplated a corporate officer who could be an independent contractor under common law, see, e.g., sec. 1607(i), I.R.C. 1939, the Court of Appeals' statements concerning common law rules "may no longer be relevant." **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, supra at 128 n.4. The opinion in **Tex. Carbonate**

Co. v. Phinney, supra at 291, recognized that, regardless of the test purportedly being applied, "such officers as work for * * *[a corporation] in fact" are included as employees. The court also addressed the impact of an alleged absence of control in that case, as follows:

> Even though an absence of control is shown, and this as we have noted has not been done, the force of the factor is diminished to near de minimis by the fact that * * * [the service provider] himself was a member of the Board of Directors, a vice president, and the executive of the Company in charge of its sales and the development of its markets. * * * [**id.** at 292.]

Hence, critical components of the analysis in **Tex. Carbonate Co. v. Phinney, supra**, are consistent with the current regulatory approach to officers and contrary to petitioner's position.

Second, from a factual standpoint, even if the common law control factor were pertinent to our evaluation, petitioner has failed to establish a lack of control over Stark in the performance of his services. As in **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner, supra**, at 128-129, to accept petitioner's contentions in this regard would be the equivalent of disregarding the corporate form in which Stark chose to conduct his business. Case law does not permit a taxpayer to use his or her dual role as a shareholder of and service provider to a corporation as grounds for ignoring the legal ramifications of the business construct so selected. **Molina Props., Inc. v. Commissioner**, 319 U.S. 436, 438-439 (1943); **Joseph M. Grey Pub. Accountant v. Commissioner, supra**, at 129.

3. Application of Section 3121(d)(1)

On the basis of the foregoing analysis, application of section 3121(d)(1) is not precluded or limited here by considerations pertaining to Stark's status as an S corporation shareholder or under the common law. Section 3121(d)(1) and sections 31.3121(d)-1(b) and 31.3306(1)-1(e), Employment Tax Regs., specify that corporate officers are to be classified as employees if they perform more than minor services and receive or are entitled to receive remuneration. The overwhelming weight of the evidence here shows that Stark's activities vis-a-vis petitioner met these criteria. (Accordingly, considerations with respect to burden of proof do not affect our analysis on this point.) Stark at all relevant times served as petitioner's president and worked in all significant aspects of petitioner's business operations. Stark also obtained remuneration from petitioner's bank account as his needs arose.

Furthermore, although section 3121(d)(1) may be inapplicable to the extent that an officer performs services in some other capacity, i.e., as an independent contractor, petitioner has neither contended nor offered evidence that Stark worked for or was engaged by petitioner in a capacity other than as an officer. See **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. at 129-130; Rev. Rul. 82-83, 1982-1 C.B. 151, 152. Hence, we conclude that Stark was an employee of petitioner for employment tax purposes, in accordance with section 3121(d)(1).

B. Availability of Section 530 Relief

Section 530 affords relief from employment tax liability, notwithstanding an adverse classification, where the following three requirements are satisfied: (1) The taxpayer

has not treated the individual, or any individual holding a substantially similar position, as an employee for any period; (2) the taxpayer has consistently treated the individual as not being an employee on all tax returns for periods after December 31, 1978, and (3) the taxpayer has a reasonable basis for not treating the individual as an employee. Sec. 530(a)(1), (3). With respect to the case at bar, respondent has conceded that petitioner meets the first of the above requirements and does not argue that petitioner fails to meet the second. Rather, the parties dispute whether petitioner had a reasonable basis for not treating Stark as an employee.

Concerning the existence of a reasonable basis for purposes of Section 530(a)(1), Section 530(a)(2) sets forth three statutory safe havens. Reliance upon any of the circumstances enumerated in subparagraph (A), (B), or (C) of Section 530(a)(2) is deemed sufficient to establish the requisite reasonable basis.

Subparagraph (A) lists judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer. The amended petition alleges:

> The Petitioner did not treat its sole shareholder, Ronald A. Stark, as an employee during any part of 1996, 1997 and 1998, and the reasonable basis for not treating Ronald A. Stark as an employee for the said periods is based on judicial precedent contained in the opinion of the 5th Circuit Court of Appeals in **Texas Carbonate Company v. R.L. Phinney**, 307 F.2d 289 (5th Cir.), **cert. denied**, 371 U.S. 940 (1962).

On brief, petitioner reiterates reliance on **Tex. Carbonate Co. v. Phinney**, 307 F.2d 289 (5th Cir. 1962), and cites as well to **Automated Typesetting, Inc. v. United States**, 527 F. Supp. 515 (E.D. Wis. 1981), in support of the

premise that petitioner reasonably looked to common law concepts in classifying Stark.

For the reasons previously discussed, **Tex. Carbonate Co. v. Phinney**, supra, does not afford a reasonable basis for disregard of the explicit rules of section 3121(d)(1) and sections 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs.. Equally unavailing in this regard is **Automated Typesetting, Inc. v. United States, supra**. The District Court in that case simply evaluated the employment relationship of the involved individuals both through a common law analysis and through application of the provisions relating to corporate officers. **Id.** at 519-522. In deciding that the individuals qualified as employees under either rubric, the court did not repudiate the statutory treatment of corporate executives. **Id.** at 520, 522; see also **Joseph M. Grey Pub. Accountsnt, P.C. v. Commissioner, supra** at 129 n.5.

Moreover, even if we were to assume arguendo that the cited cases offer a reasonable basis for treating an officer as a nonemployee, petitioner has failed to establish reliance on the claimed precedent as a factual matter. To fall within the safe harbors of Section 530(a)(2), the taxpayer must have relied on the alleged authority during the periods in issue at the time the employment decisions were being made, The statute does not countenance ex post facto justification. See **303 W. 42nd St. Enters., Inc. v. IRS,** 181 F.3d 272, 277, 279 (2d Cir. 1999) (reversing and remanding because it was "unclear from the record whether * * * [the taxpayer] in fact relied on any specific industry practice in reaching its decision to treat its * * * [workers] as non-employee tenants, let alone whether such reliance was reasonable"); **Select Rehab, Inc. v. United States,** 205 F.Supp. 2d 376, 380 (M.D. Pa. 2002) ("the taxpayer must show that it relied upon those grounds [alleged as a reasonable basis], and that the reliance was

was reasonable."); **W. Va. Pers. Servs., Inc. v. United States**, 78 AFTR 2d 96-6600, at 96-6608, 96-2 USTC par. 50,554 at 85,919 (S.D. W. Va. 1996) ("The plain meaning of section 530(a)(2) is that only evidence known to and relied upon by the taxpayer is relevant. Facts that are learned after the incorrect treatment of the employees * * * are not facts that a taxpayer relied upon in making its original decision regarding how to treat its employees.").

Until a few months before trial, petitioner did not purport to rely on Section 530 or the bases described therein and expressly disclaimed any dependence on the statute. Petitioner's present claim of reliance is not credible. At trial, Stark testified as a witness but presented no evidence that he was aware of **Tex. Carbonate Co. v. Phinney, supra**, or that anyone had ever discussed the case with him.

Petitioner proposed to call Grey, the accountant who advised petitioner and prepared petitioner's tax returns. Grey was not allowed to testify in this case because he had not been listed as a witness in petitioner's trial memorandum, in violation of this court's standing Pre-Trial Order. See Rule 131(b). His testimony, in any event, would not have made a difference. See **Veterinary Surgical Consultants, P.C. v. Commissioner**, T.C. Memo 2003-48 (where Grey testified that he was unaware of the **Tex. Carbonate Co. v. Phinney, supra**, case until posttrial briefing, during the fall of 2001, in **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. 121 (2002)). Petitioner failed to establish that it relied on judicial precedent, or, for that matter, on any of the other sources specified in Section 530(a)(2)(A). Accordingly, we conclude that subparagraph (A) does not aid petitioner here.

The same result obtains with respect to

subparafraphs (B) and (C). The parties have stipulated that respondent did not audit petitioner for employment tax purposes prior to the examination underlying the present case. Petitioner therefore cannot show reliance on a past audit under Section 530(a)(2)(B). Likewise, petitioner has adduced no evidence of conventions in the residential home improvement industry to establish longstanding industry practice under Section 530(a)(2)(C). The safe havens of Section 530(a)(2) are therefore inapplicable on the record before us.

In seeking to establish a reasonable basis for Stark's treatment apart from the safe havens, petitioner quotes from the following definition of "employment status" in Section 530(c)(2): "The term 'employment status' means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an e,ployee)." Petitioner apparently believes that the purported lack of common law control makes its treatment of Stark reasonable within the meaning of Section 530 and that the above definition supports this view.

Again, however, petitioner's approach is contrary to controlling statutes and to the facts of this case. As a matter of construction, Section 530(c)(2) defines employment status for purposes of certain provisions of Section 530 not germaine here. It does not purport to override or interpret the definition of "employee" in section 3121(d)(1) and related regulations. Hence Section 530(c)(2) does not render it rational for petitioner to have ignored the statutory mandate regarding corporate officers and to have taken a position that was not otherwise supported by authority. Petitioner also does not claim in actuality to have relied on Section 530(c)(2) in deciding not to treat Stark as an employee in

1996, 1997, or 1998. We conclude and have found as a fact that petitioner did not have a reasonable basis for failing to characterize Stark as an employee. Consequently, relief from employment tax liability is not available to petitioner under Section 530.

Lastly, in connection with Section 530, petitioner raises a due process argument. This issue has never been properly pled by petitioner. Rather, petitioner mentioned due process in its motion for leave to file an amended petition, did not allege a due process violation in the amended petition itself, and argued the matter only on brief. Generally, issues not properly raised prior to briefing will not be considered when to do so would prevent the opposing party from presenting evidence that might have been offered if the issue had been timely raised. **DiLeo v. Commissioner**, 96 T.C. 858, 891 (1991), affd. 959 F.2d 16 (2d Cir. 1992); **Shelby U.S. Distribs., Inc. v. Commissioner**, 71 T.C. 874, 885 (1979). Here, however, even if we were to treat the due process issue as appropriately before us, petitioner's position is without merit.

Section 530(e)(1) provides that the Internal Revenue Service "shall, before or at the commencement of any audit inquiry relating to the employment status of one or more individuals who perform services for the taxpayer, provide the taxpayer with a written notice of the provisions of this section." Small Business Job Protection Act of 1996 sec. 1122(a), 110 Stat. 1766. On brief, petitioner alleges that it learned of the existence of Section 530 only through the June 8, 2001, notice of determination, which postdated by a substantial margin the commencement on August 6, 1999, of the underlying employment tax audit. Petitioner then states:

> The inaction of Respondent in not providing the required notice to Petitioner is a

serious Constitutional violation of due process, and Petitioner moves this Court to allow Petitioner to recover its legal fees, since the conduct of the Respondent is so egregious in this matter.

To the extent that petitioner's due process contentions take the form of a claim for litigation or administrative costs and fees under section 7430, such claim is premature. Rule 231(a)(2), as pertinent here, specifies that the appropriate time to seek recovery of legal costs follows service of a written opinion. See **McWilliams v. Commissioner**, 104 T.C. 320, 327 (1995); **Groetzinger v. Commissioner**, 87 T.C. 533, 548 (1986).

Furthermore, even if petitioner's allegations might be read as a plea encompassing other remedies, petitioner has failed to show that its situation satisfies the prerequisites for relief under the Due Process Clause. As this Court has noted, even in a criminal context defendants are generally required to establish actual prejudice in order to obtain due process relief. **Riland v. Commissioner**, 79 T.C. 185, 197-198 (1982) (involving a claimed denial of due process on account of delay in issuance of the subject deficiency notice). The record in the instant case is decoid of evidence of such prejudice. Although petitioner was made aware of Section 530 at least prior to filing its petition with the Court, petitioner failed therein to raise the statute. Nonetheless, petitioner was subsequently granted leave to file an amended petition specifically to place at issue its right to relief under Section 530. The matter (of substantive relief under Section 530(a), not, as previously noted, of a due process violation based on Section 530(e)(1) notice procedures) therefore was properly before the Court at trial, and petitioner was afforded an opportunity to be heard. Accordingly, no actual prejudice was

sustained.

The above analysis is consistent with our recent jurisprudence on the notice provision contained in section 3463(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, 112 Stat. 767. In **Smith v. Commissioner**, 114 T.C. 489 (2000), affd. 275 F.3d 912 (10th Cir. 2001), we considered this requirement that the Commissioner include on each notice of deficiency the last date for filing a petition with the Tax Court. We held that, where the Commissioner failed to place such date on the notice, but the taxpayers nonetheless received the notice and filed a petition in a timely manner, the notice was valid. **Id.** at 492. In so holding, we noted the absence of any delay prejudicial to the taxpayers' ability to petition the Court. **Id.** at 491-492.

Thus, failure to comply with certain procedural notice requirements does not rise to the level of a denial of due process where, as here, the taxpayer's opportunity to present its position is not prejudiced.

C. Conclusion

We hold that Stark is an employee of petitioner pursuant to section 3121(d)(1) and that petitioner is not entitled to relief under Section 530. Accordingly, petitioner is liable for FICA and FUTA taxes for the periods in issue as set forth in respondent's notice of determination and relevant stipulations.

To reflect the foregoing,

Decision will be entered for respondent and in accordance with stipulations as to amounts.

UNITED STATES TAX COURT

Washington, DC 20217

NU-LOOK DESIGN, INC., Petitioner	*	
v.	*	Docket No. 10368-01
COMMISSIONER OF INTERNAL REVENUE, Respondent	*	EMPLOYMENT

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion (T.C. Memo 2003-52) filed February 26, 2003, it is hereby

ORDERED and DECREED, that Ronald A. Stark is classified as an employee of petitioner for purposes of federal employment taxes under Subtitle C of the Internal Revenue Code with respect to the taxable quarters ended March 31, 1996; June 30, 1996; September 30, 1996; December 31, 1996; March 31, 1997; June 30, 1997; September 30, 1997; December 31, 1997; March 31, 1998, June 30, 1998; September 30, 1998; and December 31, 1998.

That petitioner is not entitled to relief under Section 530 of the Revenue Act of 1978 with respect to Ronald A. Stark.

That the proper amounts of employment tax under the above determination are as shown below:

Federal Insurance Contributions Act (FICA) Tax Imposed Under I.R.C. Secs. 3101, 3102(a), and 3111

Tax Period Ended	Amount of Tax
Mar. 31, 1996	$ 416
June 30, 1996	416

Sept. 30, 1996	416
Dec. 31, 1996	416
Mar. 31, 1997	416
June 30, 1997	416
Sept. 30, 1997	416
Dec. 31, 1997	416
Mar. 31, 1998	273
June 30, 1998	273
Sept. 30, 1998	273
Dec. 31, 1998	273

Federal Unemployment Tax Act (FUTA)
Tax Imposed Under I.R.C. Sec. 3301

Dec. 31, 1996	$ 434
Dec. 31, 1997	434
Dec. 31, 1998	434

/s/ Mary Ann Cohen
Judge

Entered: MAR 10 2003

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Case No. 03-2754

NU-LOOK DESIGN, INC.,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

SUR PETITION FOR REGEARING

Present: SCIRICA, Chief Judge,
SLOVITER, NYGAARD, ALITO, ROTH, McKEE,
RENDELL, BARRY, AMBRO, FUENTES, SMITH,
CHERTOFF, FISHER, Circuit Judges, and
POLLAK, District Judge*

The petition for rehearing filed by appellant in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular service not having voted for rehearing, the petition for rehearing by the panel and the Court en banc, is denied.

BY THE COURT,

/s/ D. Brooks Smith

Circuit Judge

Dated: April 1, 2004

CRG/cc: JO
RF
RSM

Received and Filed

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*The vote of the Honorable Louis H. Pollak, Senior District Judge for the Eastern District of Pennsylvania, who sat by designation, was limited to panel rehearing.

4/1/04 /s/ CRB

Marcia M. Waldron,
Clerk

36a-BCD

NOT PRECEDENTIAL

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 02-4417, 03-2756 and 03-2757

JOSEPH M. GREY PUBLIC ACCOUNTANT, P.C.,
Appellant No. 02-4417

v.

COMMISSIONER OF INTERNAL REVENUE

WATER-PURE SYATEMS, INC.,
Appellant No. 03-2756

v.

COMMISSIONER OF INTERNAL REVENUE

MIKE J. GRAHAM TRUCKING, INC.,
Appellant No. 03-2757

v.

COMMISSIONER OF INTERNAL REVENUE

On Appeal from the United States Tax Court

No. 02-4417
Tax Judge: The Honorable James S. Halpern
(Tax Ct. No. 00-4789)

No. 03-2756
Tax Judge: The Honorable Mary Ann Cohen
(Tax Ct. No. 01-11344)

No. 03-2757
Tax Judge: The Honorable Mary Ann Cohen
(Tax Ct. No. 00-4799)

37a-BCD

Submitted under Third Circuit LAR 34.1
March 23, 2004

Before:
FUENTES, SMITH and GIBSON,*
Circuit Judges

(Filed: April 7, 2004)

OPINION OF THE COURT

SMITH, Circuit Judge.

The Internal Revenue Service ("IRS") classified an officer and shareholder of each of the appellant corporate taxpayers as an employee for purposes of federal employment taxes. The Notice of Determination sent to each of the taxpayers and advising of them of this classification also indicated that the taxpayer was not entitled to relief under Section 530 of the Revenue Act of 1978. See Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (amended by Act of Dec. 29, 1979, Pub. L. No. 96-167, 93 Stat. 1275; Act of Dec. 17, 1980, Pub. L. No. 96-541, 94 Stat. 3204; Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324; Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085; and Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755)(hereinafter cited as "Section 530"). As a result, each of the corporate taxpayers was assessed employment taxes for its respective employee under the Federal Insurance Contributions Act ("FICA"), 26 U.S.C. Secs. 3101-3128, and the Federal Unemployment Tax Act ("FUTA"), 26 U.S.C. Secs. 3301-3311.

*Honorable John R. Gibson, Senior Circuit Judge for the U.S. Court of Appeals for the 8th Circuit, sitting by designation.

Taxpayer, J eph M. Grey Public Accountant, P.C. ("JMG") received a Notice of Determination in February 2000 advising that the IRS had classified Mr. Grey as JMG's employee. JMG, a subchapter S corporation, operated as a public accounting, bookkeeping and tax return preparation business. Mr. Grey was JMG's president and sole shareholder. During the tax years at issues, Mr. Grey solicited the corporation's business, transacted its affairs, handled the financial aspects of the operation and "performed all accounting, bookkeeping and tax preparation services." JMG did not make any regular payments to Mr. Grey for the services he rendered during the tax years at issue. Instead, Mr. Grey received money from JMG's bank account as his needs arose. Those payments were reported on Mr. Grey's federal return as non-passive income.

Taxpayer Mike J. Graham Trucking, Inc. ("MJG") also received a Notice of Determination issued in February 2000. The classification pertained to Mr. Graham, MJG's majority shareholder an president. MJG was also a subchapter S corporation, operating as a trucking company. Mr. Graham solicited business for the company, handled its business transactions, managed its finances and performed the driving services rendered by the company. MJG did not provide Mr. Graham with a salary or wages during the tax years in dispute. Rather, Mr. Graham distributed money to himself from MJG's bank account as his needs arose, or he paid certain personal expenses which he or his family incurred from the business account. Mr. Graham reported the payments as non-passive income on the K-1 Schedule of his federal return.

Water Pure Systems, Inc. received a Notice of Determination dated June 8m 2001, classifying Martin Ridge as Water Pure's employee for federal employment tax purposes. Water Pure, a subchapter

S corporation, "provided sales and service of water filtration and purification systems." Mr. & Mrs. Ridge each owned 50% of Water Pure's shares and Mr. Ridge was Water Pure's president and sole officer. Mr. Ridge was the only person performing any services for Water Pure. Water Pure did not distribute any dividends to any shareholder during the tax years at issue. Nor did Mr. Ridge receive regular payments from Water Pure. Instead, he received money from the corporation as his needs arose and those payments were reported as non-passive income on his Schedule K-1 of his federal tax return.

Taxpayers JMG, Water Pure and MJG challenged both the worker classifications and the determination that they were not entitled to relief under Section 530. The Tax Court concluded that the classifications were appropriate and that relief was not available under Section 530's safe harbor provision. These appeals followed. We exercise jurisdiction pursuant to 26 U.S.C. Sec. 7482(a). We give "plenary review of the Tax Court's findings of law, including its construction and application of the Internal Revenue Code." **PNC Bancorp, Inc. v. Comm'r**, 212 F.3d 822, 827 (3d Cir. 2000).

Each of the taxpayers contend that the Tax Court erred because the taxpayer neither controlled nor employed the worker who was classified as an employee. Rather, they contend that the remuneration each worker received was attributable to his status as an officer and shareholder of his respective corporation. They urge this Court to disregard the statutory definitions of "employee" in the Internal Revenue Code and in the Treasury regulations, and to apply the usual common law rules for determining whether an individual is an employee. Alternatively, the taxpayers argue that they had a reasonable basis for not treating each worker as an employee and are entitled to relief from the assessment of the FICA and FUTA taxes under

U.S.C. Sec. 3121(d)(3). This argument was not raised before the Tax Court and we will not consider it for the first time on appeal. **Harris v. City of Philadelphia**, 35 F.3d 840, 845 (3d Cir. 1994).

We have recently addressed and rejected in **Nu-Look Design, Inc. v. Commissioner**, 356 F.3d 290 (3d Cir. 2004), a similar challenge to the Tax Court's determination that the IRS's classification of a corporate officer and shareholder as an employee was appropriate and that the taxpayer was liable under the FICA and the FUTA. After careful review of each record, we are unable to distinguish any of these appeals from **Nu-Look Design**. Accordingly, **Nu-Look Design** controls and we will affirm the decisions of the Tax Court.

41a-BCD

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 02-4417, 03-2756 and 03-2757

JOSEPH M. GREY PUBLIC ACCOUNTANT, P.C.,
Appellant No. 02-4417

v.

COMMISSIONER OF INTERNAL REVENUE

WATER-PURE SYSTEMS, INC.,
Appellant No. 03-2756

v.

COMMISSIONER OF INTERNAL REVENUE

MIKE J. GRAHAM TRUCKING, INC.,
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COMMISSIONER OF INTERNAL REVENUE

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No. 02-4417
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Tax Judge: The Honorable Mary Ann Cohen
(Tax Ct. No. 01-11344

No. 03-2757
Tax Judge: The Honorable Mary Ann Cohen
(Tax Ct. No. 00-4799)

Submitted Under Third Circuit LAR 34.1
March 23, 2004

Before:
FUENTES, SMITH and GIBSON,* Circuit Judges

JUDGMENT

These cases came on to be heard from the United States Tax Court and were submitted on March 23, 2004. On consideration whereof, it is now here

ORDERED AND ADJUDGES by this Court that the decisions of the United States Tax Court entered on September 19, 2002 with respect to Joseph M. Grey, P.C., and on March 10, 2003 with respect to Water Pure Systems, Inc. and Mike J. Graham Trucking, Inc., be and the same are hereby AFFIRMED. All of the above in accordance with the opinion of this Court. Costs taxed against Appellants.

ATTEST:

/s/ Patricia Dodszuweit

Acting Clerk

Dated: April 7, 2004

*Honorable John R. Gibson, Senior Circuit Judge for the United States Court of Appeals for the Eighth Circuit, sitting by designation.

119 T.C. No. 5

UNITED STATES TAX COURT

JOSEPH M. GREY PUBLIC ACCOUNTANT, P.C., Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 4789-00. Filed September 16, 2002.

This is an action for redetermination of employment status. G is the president and sole shareholder of P, an S corporation. P failed to treat G as an employee. R determined that G was an employee of P's for purposes of Federal employment taxes.

1. **Held:** P is subject to Federal employment taxes since G, an officer, is an employee within the meaning of secs. 3121(d)(1) and 3306(i), I.R.C.

2. **Held further**, P had no reasonable basis for not treating G as an employee and therefore is not entitled to relief pursuant to sec. 530 of the Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2763, 2885, as amended.

3. **Held, further**, alternatively, P is not entitled to relief under sec. 530 of the Revenue Act of 1978, because such provision is limited to worker classification issues arising under the common law.

SERVED SEP 16 2002

Joseph M. Grey (an officer), for petitioner

Linda P. Azmon, for respondent

OPINION

HALPERN, **Judge:** This is an action for redetermination of employment status. On February 23, 2000, respondent mailed to petitioner a Notice of Determination Concerning Worker Classification under Section 7436 (the notice). By the notice, respondent informed petitioner that he had determined that Joseph M. Grey is classified as an employee of petitioner's for purposes of the Federal employment taxes imposed by subtitle C of the Internal Revenue Code and that petitioner is not entitled to relief from that classification under section 530 of the Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2885, as amended (section 530). Attached to the notice is a schedule (the schedule) setting forth petitioner's liabilities for (1) Federal Insurance Contribution Act (FICA) taxes and (2) Federal Unemployment Tax Act (FUTA) taxes, as follows:

Tax	Quarter or Year	Amount
FICA	1/1995	$1,430
FICA	2/1995	1,430
FICA	3/1995	1,430
FICA	4/1995	1,430
FICA	1/1996	1,430
FICA	2/1996	1,430
FICA	3/1996	1,430
FICA	4/1996	1,430
FUTA	1995	434
FUTA	1996	434

On May 1, 2000, petitioner filed a timely petition for review of respondent's determinations, and, on July 24, 2000, petitioner filed an amended petition for such review. The parties agree that if, for Federal employment tax purposes, Mr. Grey was petitioner's employee during the periods in question, and section 530 relief is not available, then the schedule accurately sets forth petitioner's liabilities for Federal employment taxes for those periods.

The issues for decision are whether Mr. Grey was petitioner's employee for these purposes and, if so, whether petitioner is entitled to relief under section 530. In its amended petition, petitioner disclaimed reliance on sec. 530. When this case was called for trial, petitioner moved to amend its amended petition to raise sec. 530. petitioner agreed to rely solely on the stipulation of facts to support its claim for relief under sec. 530. On that basis, respondent had no objection to petitioner's motion, and the Court granted it.

Unless otherwis indicated, all section references are to the Internal Revenue Code in effect for the taxable periods at issue, and all Rule references are to the Tax Court Rules of Practice and Procedure. For convenience, dollar amounts have been rounded to the nearest dollar. Petitioner bears the burden of proof. See Rule 142(a). Sec. 530(e)(4) places the burden of proof on the Secretary with respect to certain aspects of sec. 530. Sec. 530(e)(4) applies to disputes involving periods after December 31, 1996, and therefore does not apply to this case. Small Business Job Protection Act of 1996, Pub. L. 104-188, sec. 1122(b)(3), 110 Stat. 1766 (1996 Act). Sec. 7491, which shifts the burden of proof to the Secretary in certain other circumstances, does not apply to employment tax disputes. Sec. 7491(a)(1).

Background

This case was submitted fully stipulated under Rule 122. The facts stipulated by the parties are so found. The stipulation of facts, with accompanying exhibits, is incorporated herein by this reference. The following is a summary of the facts necessary for our discussion.

Principal Place of Business

At the time the petition was filed,

petitioner's principal place of business was in Philadelphia, Pennsylvania.

History

On April 11, 1991, petitioner was organized as a Pennsylvania professional corporation. Since its organization petitioner has operated as a public accounting, bookkeeping, and tax preparation firm. That is petitioner's only business and its only source of income. Petitioner is an S corporation within the meaning of section 1361(a)(1).

Joseph M. Grey

Since petitioner's organization, Mr. Grey has been petitioner's sole shareholder and its president. Petitioner rents part of Mr. Grey's personal residence for use as an office at a monthly rental of $500. During 1995 and 1996, Mr. Grey performed the following services for petitioner:

1. Solicited business on behalf of petitioner;
2. Ordered petitioner's supplies;
3. Entered into verbal and/or written agreements on behalf of petitioner;
4. Oversaw the finances of petitioner;
5. Collected moneys owed petitioner;
6. Managed petitioner;
7. Purchased petitioner's supplies;
8. Obtained clients for petitioner;
9. Maintained customer satisfaction;
10. Performed all bookkeeping services for petitioner;
11. Performed all accounting, bookkeeping, and tax preparation services for petitioner on behalf of petitioner's clients.

During 1995 and 1996, all receivables collected by petitioner were deposited into its checking account. Mr. Grey was the only person with signature authority over that account.

During 1995 and 1996, petitioner did not make regular payments at fixed times to Mr. Grey for his services. Rather, Mr. Grey would take money from petitioner's account to pay for his needs as they arose.

Petitioner did not distribute any dividend to any shareholder during 1995 or 1996, and petitioner did not classify any payment made to Mr. Grey as a dividend in 1995 or 1996.

Petitioner's Returns

For each of 1995 and 1996, petitioner made its return of income on a Form 1120S, U.S. Income Tax Return for an S Corporation (the Forms 1120S). Petitioner reported ordinary income from business of $33,196 and 24,990 for 1995 and 1996, respectively. In calculating those amounts of ordinary income, petitioner claimed no deductions for either compensation of officers or salaries and wages. Petitioner did claim deductions for independent contractor fees in the amounts of $6,000 and $7,200 for 1995 and 1996, respectively, and deductions for rent in the amounts of $193 and $7,040, respectively, for those years. Both the 1995 and the 1996 Form 1120S are signed by Mr. Grey, as president of petitioner, and are dated January 18, 1996, and December 26, 1997, respectively.

For both 1995 and 1996, petitioner issued Mr. Grey a Form 1099-MISC (the Forms 1099-MISC, reporting nonemployee compensation of $6,000 and $7,200, respectively. For both years, petitioner transmitted copies of such forms to the Internal Revenue Service by filing a Form 1096, Annual Summary and Transmittal of U.S. Information Returns (the Forms 1096). Both the 1995 and the 1996 Form 1096 are signed by Mr. Grey, as president of petitioner, and are dated January 12, 1996, and March 18, 1997, respectively. Petitioner also issued Mr. Grey Schedules K-1, Shareholder's Share of Income, Credits, Deductions, etc. (the Schedules K-1), showing

that, for 1995 and 1996, his share of petitioner's ordinary income from business was $33,196 and 24,990, respectively.

Mr. Grey's Returns

For each of 1995 and 1996, Mr. Grey made his return of income on Form 1040, U.S. Individual Income Tax Return. He reported income from petitioner in the amounts shown on the Schedules K-1; i.e., $33,196 and 24,990, for 1995 and 1996, respectively. For 1995, on Schedule C, Profit or Loss From Business, he reported $6,000 classified as "management and Storage Rental of Office Space for Corporation, and Management and Accounting Services: 1099-MISC received". For 1996, on Schedule C, he reported $7,200, without any identification; on Form 4831, Rental Income, he reported $6,000 as rental income attributable to his personal residence.

Discussion

I. Statutory and Regulatory Background

A. Internal Revenue Code and Employment Tax Regulations

Sections 3111 and 3301 impose employment taxes upon employers under FICA and FUTA, respectively, based on wages paid to employees. Section 3121(d) defines the term "employee" for purposes of the FICA tax. With certain modifications not relevant here, this definition applies for purposes of the FUTA tax as well. Sec. 3306(i).

Under sec. 3121(d)(2), the term "employee" includes any individual who has the status of an employee under the common law. Paragraphs (1), (3), and (4) of sec. 3121(d) describe other individuals who are considered employees regardless of their status under the common law. Individuals described in those paragraphs are commonly referred to as "statutory" employees.

One such category of statutory employees consists of officers of corporations. Sec. 3121(d)(1). Sec. 31.3121(d)-1(b), Employment Tax Regs., limits that category as follows:

> (b) Corporate Officers. - - Generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is considered not to be an employee of the corporation.
> * * *

Sec. 31.3306(i)-1(e), Employment Tax Regs., contains a like limitation srecifically applicable to the FUTA tax.

B. Section 530 of the Revenue Act of 1978

Sec. 530 provides in relevant part as follows:

SEC. 530. CONTROVERSIES INVOLVING WHETHER INDIVIDUALS ARE EMPLOYEES FOR PURPOSES OF THE EMPLOYMENT TAXES.

(a) Termination of certain employment tax liability - -

(1) In general. -- if--

(A) for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and

(B) in the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then

for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

(2) Statutory standards providing one method of satisfying the requirements of paragraph (1). - - For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

(A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

(B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individual holding positions substantially similar to the position held by this individual; or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

* * * * * *

(b) Prohibition against regulations and rulings on employment status. - - No regulation or Revenue Ruling shall be published on or after the date of the enactment of this Act * * * and before the effective date of any law hereafter enacted clarifying the employment status of individuals for purposes of the employment taxes by the Department of the Treasury (including the

Internal Revenue Service) with respect to the employment status of any individual for purposes of the employment taxes.

(c). Definitions. -- For purposes of this section--

(2) Employment status.--The term "employment status" means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an employee).

* * * * * * *

(e) Special rules for application of section

(1) Notice of availability od section.--Anofficeror employee of the Internal Revenue Service shall, before or at the commencement of an audit inquiry relating to the employment status of one or more individuals who perform services for the taxpayer, provide the taxpayer with a written notice of the provisions of this section.

II. Mr. Grey's Status as an Employee for Employment Tax Purposes

A. Petitioner's S Corporation Theory

As a preliminary matter, we summarily reject petitioner's argument that, because it is an S corporation that has passed its net income through to Mr. Grey as its sole shareholder pursuant to sec. 1366, there can be no employer-employee relationship between it and Mr. Grey. That argument is similar to the argument made by the taxpayer in Veterinary Surgical **Consultants, P.C. v. Commissioner**, 117 T.C. 141, 145 (2001), a case in which, it appears, the taxpayer was advised by Mr. Grey, who was the source of the taxpayer's argument there. See **Id.** at 143-144. We shall not here

repeat our refutation of that argument, which can be found in **Veterinary Surgical Consultants, P.C. Id.** at 145-146.

B. Petitioner's Reliance on the Common Law

Petitioner further asserts that, notwithstanding section 3121(d)(1), a corporate officer is not an employee for employment tax purposes unless he or she is an employee under the common law. Petitioner bases that argument on the following language from **Texas Carbonate Co. v. Phinney**, 307 F.2d 289, 291-292 (5th Cir. 1962):

> The statutory definition of "employees" as including officers of a corporation will not be so construed as to mean that an officer is an employee per se. * * * in determining whether an officer is an employee within the meaning of the statutes, the usual employer-employee tests are to be applied. * *

Petitioner then argues that Mr. Grey was not an employee at common law because petitioner never exercised control over Mr. Grey in the performance of his services. We note that petitioner ignores the following additional language from **Tex. Carbonate Co. v. Phinney**, 307 F.2d 289, 292 (5th Cir. 1962):

> Even though an absence of control is shown, and this as we have noted has not been done, the force of the factor is diminished to near de minimis by the fact that * * * [the service provider] himself was a member of the Board of Directors, a Vice President, and the executive of the Company in charge of its sales and the development of its products. * * *

Even if the common law control factor were relevant to our analysis, petitioner has failed to prove that it did not exercise control over Mr. Grey in the performance of his services. Secs. 31.3121(d)-1(b) and 31.3306(i)-1(e),

Employment Tax Regs., discussed in part I.A., **supra**, were promulgated after the years at issue in **Tex. Carbonate Co. v. Phinney, supra.** Moreover the FUTA definition of "employee" in effect for such years, while stating the general rule that such term includes corporate officers, appears to have contemplated that a corporate officer could be an independent contractor under the common law, in which case the officer would not be treated as an employee for FUTA purposes. See, e.g., sec. 1607(i), I.R.C. 1939. In light of the regulatory and statutory developments that occurred after the years at issue in **Tex. Carbonate Co. v. Phinney**, 307 F.2d at 291-292, the Court of Appeals' conclusion therein that "the usual employer-employee tests are to be applied" in determining the status of a corporate officer for employment tax purposes may no longer be relevant. See **C.D. Ulrich, Ltd. v. United States**, 692 F. Supp. 1053, 1055 (D. Minn. 1988) ("Under both the weight of the case law and under treasury regulations, a corporate officer is to be treated as an employee if he renders more than minor services."). In that regard, we not that Mr. Grey chose to do business in corporate form through petitioner. His assertion before this Court (on behalf of petitioner) that petitioner logically cannot exercise control over him in the performance of his services (presumably owing to his dual role as service provider to, and sole shareholder of, petitioner) amounts to a request that we disregard the corporate form in deciding the issue before us. That we shall not do. See **Moline Props., Inc. v. Commissioner**, 319 U.S. 436 (1943). Petitioner also cites **Automated Typesetting, Inc. v. United States**, 527 F. Supp. 515 (E.D. Wis. 1981) in support of its position that common law factors should control in determining whether a corporate officer is an employee for employment tax purposes. The court in **Automated**

Typesetting, Inc., however, did not eschew the statutory mandate regarding classification of corporate officers; rather, it simply found that the individuals in question were employees under a common law analysis as well. Petitioner's focus on the court's discussion of common law factors is therefore misplaced.

C. Emplyee Status Under Section 3121(d)(1)

Having disposed of petitioner's principal arguments, we turn next to the rather straightforward application of section 3121(d)(1). The parties have stipulated that Mr. Grey was petitioner's officer (president) and that he performed numerous services for petitioner. As a practical matter, those stipulations tend to establish Mr. Grey's status as an employee under sec. 3121(d)(1) and sec. 31.3121(d)-1(b), Employment Tax Regs.. However, it is conceivable that Mr. Grey was not acting in his capacity as president when he performed such services. See Rev. Rul. 82-83, 1982-1 C.B. 151, 152 ("It is a question of fact in all cases whether officers of a corporation are performing services within the scope of their duties as officers or whether they are performing services as independent contractors."). For the sake of completeness, we now address that possibility.

The parties did not stipulate whether Mr. Grey performed the services in question as petitioner's president or in some other capacity (i.e., as an independent contractor). However, we think it is a fair inference that Mr. Grey performed such services as petitioner's president. We know that he was president and that he performed numerous services, and there is no convincing evidence, such as a service agreement, that petitioner engaged him to perform such services as an independent contractor rather than as president. See also **Van Camp & Bennion v. United States**, 251 F.3d 862, 866 (9th Cir.

2001) ("fundamental decisions regarding the operation of the corporation * * * are customarily ,ade by corporate officers or other employees"). The only evidence that Mr. Grey may have provided services for petitioner in a capacity other than as president is the Forms 1099-MISC reporting nonemployee compensation of $6,000 and $7,200 for 1995 and 1996, respectively. Since those forms were prepared only for tax purposes and are uncorroborated, we give them no weight.

D. Conslusion

We find that Mr. Grey performed numerous services for petitioner in his capacity as petitioner's president and that he was therefore an employee of petitioner's for employment tax purposes as provided in sec. 3121(d)(1).

III. Availability of Section 530 Relief

A. In General

Sec. 530(a)(1) provides that an individual will be deemed not to be an employee of the taxpayer's for employment tax purposes, notwith-standing the actual relationship between the taxpayer and the individual, if the taxpayer must not have treated the individual as an employee for any period. Second, the taxpayer must have consistently treated the individual as not being an employee on all tax returns for periods after December 31, 1978. Third, the taxpayer must have had a reasonable basis for not treating the individual as an employee. To qualify for relief under sec. 530(a)(1), a taxpayer must satisfy all three requirements.

Respondent concedes that petitioner meets the first requirement and does not argue that petitioner fails to meet the second requirement. Rather, respondent asserts that petitioner had no reasonable basis for not treating Mr. Grey as an employee.

employee.

B. Reasonable Basis

Sec. 530(a)(2) provides a safe harbor for satisfying the reasonable basis requirement of sec. 530(a)(1). Under that safe harbor, a taxpayer will be treated as having a reasonable basis for not treating an individual as an employee if it can establish that, in so treating the individual, it reasonably relied on the existence of any of the circumstances listed in subparagraphs (A), (B), and (C) of sec. 530(a)(2). Sec. 530(e)(4) provides that, if a taxpayer makes a prima facie case that it meets the requirements of the sec. 530(a)(2) safe harbor, then the Secretary bears the burden of proving otherwise. Sec. 530(e)(4) does not apply to the periods here at issue, see **supra** note 2, and, in any event, petitioner has not made such a prima facie case. The parties did not stipulate whether petitioner relied on any of the circumstances set forth in sec. 530(a)(2), and nothing else in the record establishes what, if anything, petitioner relied on during the periods at issue in not treating Mr. Grey as an employee. Accordingly, petitioner must establish the reasonableness of its treatment of Mr. Grey without the aid of sec. 530(a)(2).

Petitioner cites **Tex. Carbonate Co. v. Phinney, supra**, and **Automated Typesetting, Inc. v. United States, supra**, in support of its assertion that it had a reasonable basis for not treating Mr. Grey as an employee. We have already discounted petitioner's reliance on those cases in our rejection of petitioner's argument that the determination of whether a corporate officer is an employee for employment tax purposes is based on the application of common law factors. For the reasons discussed in part II.B., **supra**, and in light of sec. 3121(d)(1) and sec. 31.3121(d)-1(b), Employment Tax Reg., we conclude

that those cases do not provide petitioner a reasonable basis for not treating Mr. Grey as an employee. Indeed, one might fairly question whether it is **ever** reasonable for a taxpayer to treat a statutory employee as a nonemployee for employment tax purposes; i.e., whether a service provider's status as a statutory employee precludes the application of section 530. So far as we are aware, no court has ever squarely addressed this issue. As discussed below, our own analysis of the statute and its history leads us to the conclusion that section 530 is limited to controversies involving the employment tax status of service providers under the common law (i.e., controversies involving persons who are not statutory employees). This conclusion provides an alternative ground for denying petitioner relief under section 530.

C. Analysis of the Scope of Section 530

Although subsection (a) of sec. 530 by its terms is not limited to situations involving worker classification under the common law, the same cannot be said of subsections (b) (moratorium on further guidance) and (e)(1) (notice requirement) of sec. 530. See sec. 530(c)(2), defining the term "employment status", which appears in subsections (b) and (e)(1), in terms of "the usual common law rules applicable in determining the employer-employee relationship". While it can be argued that the restricted scope of the moratorium in subsection (b) is not necessarily inconsistent with a broad interpretation of the relief provision of subsection (a), such an argument is more problematic as applied to the notice requirement of subsection (e)(1). Sec. 530(e)(1) applies to audits commencing after Dec. 31, 1996. 1196 Act sec. 1122(b)(2). Because we refer to sec. 530(e)(1), we need not determine (and the parties have not established) whether sec. 530(e)(1) itself applies to this case. That is, under a

broad interpretation of subsection (a), some taxpayers who are eligible for relief under that subsection would be entitled to notice of the existence of such relief in accordance with subsection (e)(1), while other potentially eligible taxpayers would not be entitled to such notice. It is difficult to conceive that Congress intended such a bifurcated notice provision.

The history of the enactment of sec. 530 confirms that Congress did not intend sec. 530(a) to apply in the case of a statutory employee. H. Rept. 95-1748 (1978), 1978-3 C.B. (Vol. 1) 629, is the report of the Committee on Ways and Means (the committee) that accompanied H.R. 14159, 95th Cong., 2d Sess. (1978), the text of which was generally followed by the conference committee in formulating the conference agreement that was enacted as section 530 of the Revenue Act of 1978, Pub. L. 95-600, 93 Stat. 2885. See H. Conf. Rept. 95-1800 (1978), 1978-3 C.B. (Vol. 1) 521, 605. In H. Conf. Rept. 95-1748 at 3 (1978), **supra**, 1978-3 C.B. at 631, the committee reports: "With certain limited statutory exceptions, the classification of particular workers or classes of workers as employees or independent contractors (self-employed persons) for purposes of Federal employment taxes must be made under common law rules." The committee states as reasons for a change in the law (1) increased enforcement by the Internal Revenue Service (IRS) of the employment tax laws and (2) complaints by taxpayers that proposed reclassifications by the IRS involve a change of position by the IRS in interpreting how the common law rules apply to their workers or industry. **Id.** at 3-4, 1978-3 C.B. (Vol. 1) at 631-632. The committee describes H.R. 14159, **supra**, as follows:

> The bill provides an interim solution for controversies between the Internal Revenue Service and taxpayers involving whether

certain individuals are employees under interpretations of the common law by --

(1) terminating certain employment tax liabilities for periods ending before January 1, 1979,

(2) allowing taxpayers, who had a reasonable basis for not treating workers as employees in the past, to continue such treatment without incurring employment tax liabilities for periods ending before January 1, 1980, while the committee works on a comprehensive solution, and

(3) prohibiting the issuance of Treasury regulations and Revenue Rulings on common law status before 1980.

Id. at 4, 1978-3 C.B. (Vol. 1) at 632.

As evidenced by H.Rept. 95-1748 (1978), **supra**, the purpose of H.R. 14159, **supra**, was to provide an interim solution to controversies over common law employment status by, in part, allowing taxpayers who had a reasonable basis for not treating workers as employees under the traditional common law tests to continue to do so, while Congress worked on a comprehensive solution to the common law classification problem. There s no suggestion in H. Rept. 95-1748, supra, of any controversy concerning the classification of workers as statutory employees that required any solution (interim or comprehensive) by Congress. It is, therefore, a fair inference that the reasonable basis provision was intended only as an interim solution to disputes over common law employment status.

The subsequent history of sec. 530 is consistent with the history described above. By amendments to sec. 530, the interim solution encompassed in H.R. 14159, supra, has been extended indefinitely. There is no indication in

the legislative history of these amendments that Congress sought to solve any problem with respect to the classification of statutory employees. Most recently, Congress amended sec. 530 by adding subsection (e) thereto pursuant to sec. 1122 of the Small Business Job Protection Act of 1996, Pub. L. 104-188, 110 Stat. 1766 (1996 Act). H. Conf. Rept. 104-737 (1996), 1996-3 C.B. 741, is the conference committee report that accompanied H.R. 3448, 104th Cong., 2d Sess (1996), which, as enacted, became the 1996 Act. H. Conf. Rept. 104-737, at 199 (1996), 1996-3 C.B. 741, 939, makes clear the conferees' view: "[Section 530] generally allows a taxpayer to treat a worker as not being an employee for employment tax purposes * * *, regardless of the individual's actual status under the common-law test, unless the taxpayer has no reasonable basis for such treatment."

D. Conclusion

We find that petitioner is not entitled to relief under sec. 530 on the alternative grounds that (1) petitioner had no reasonable basis for not treating Mr. Grey as an employee, and (2) relief under sec. 530 is not available with respect to statutory employees.

IV. Summary

We have found that Mr. Grey was an employee of petitioner's within the meaning of sec. 3121(d)(1) and that petitioner is not entitled to relief under sec. 530. Therefore, petitioner is liable for Federal employment taxes for the periods at issue as set forth in respondent's notice.

To reflect the foregoing,

Decision will be entered for respondent and in accordance with the parties' stipulations as to amounts.

UNITED STATES TAX COURT

WASHINGTON, DC 20217

JOSEPH M. GREY PUBLIC ACCOUNTANT, P.C.,	)	Docket No. 4789-00
Petitioner,	)	
	)	**EMPLOYMENT**
v.	)	
	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to the determination of this Court as set forth in its opinion (119 T.C. No. 5) filed September 16, 2002, it is

ORDERED AND DECIDED that petitioner is not entitled to relief under Section 530 of the Revenue Act of 1978, as amended. It is further

ORDERED AND DECIDED that Joseph M. Grey is classified as an employee of petitioner for purposes of Federal employment taxes under Subtitle C of the Internal Revenue Code with respect to the taxable quarters ending March 31, 1995, through and including December 31, 1995, and March 31, 1996, through and including December 31, 1996; and that the proper amounts of employment tax under the above determination are as shown below:

Tax	Tax Period Ended	Amount
FICA	03/1995	$1,430
FICA	06/1995	1,430
FICA	09/1995	1,430
FICA	12/1995	1,430
FICA	03/1996	1,448
FICA	06/1996	1,448
FICA	09/1996	1,448
FICA	12/1996	1,448
FUTA	12/1995	434
FUTA	12/1996	434

/s/ James S. Halpern

James S. Halpern,
Judge

ENTERED: SEP 19 2002

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T.C. Memo. 2003-49

UNITED STATES TAX COURT

MIKE J. GRAHAM TRUCKING, INC., Petitioner v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 4799-00 Filed February 26, 2003.

Joseph H. O'Donnell, Jr., for Petitioner.

Linda F. Azmon, for Respondent.

MEMORANDUM FINDING OF FACTS AND OPINION

COHEN, Judge: The petition in this case was filed in response to a Notice of Determination Concerning Worker Classification Under Section 7436 (notice of determination) regarding petitioner's liabilities pursuant to the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) for 1995, 1996, and 1997. The issues for decision are (1) Whether Michael J. Graham (Graham) was an employee of petitioner for Federal employment tax purposes during 1995 through 1997 and, if so, (2) whether petitioner is entitled to relief under sec. 530 of the Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2885, as amended (sec. 530).

Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure. For convenience, FICA and FUTA taxes are collectively referred to as employment taxes.

FINDINGS OF FACT

Some of the facts have been stipulated, and the stipulated facts are incorporated in our findings by this reference.

Petitioner's Organization and Operations

Petitioner is an S corporation that was incorporated in Pennsylvania on or about July 29, 1991. At all relevant times, petitioner's principal place of business was located in Bensalem, Pennsylvania.

Since its organization, petitioner has operated as a trucking company. This activity was and is petitioner's only business and only source of income. Ownership of petitioner from the time of its incorporation and throughout 1995, 1996, and 1997 has been distributed as set forth below:

Shareholder	Number of Shares
Michael J. Graham	60
Reva G. Graham	15
Bethann Graham	25

Reva G. Graham (Mrs. Graham) and Bethann Graham are the wife and daughter, respectively, of Graham.

Graham has at all times served as petitioner's president. During 1995, 1996, and 1997, Graham performed the following services for petitioner: (1) Drove a truck on behalf of petitioner; (2) solicited business on behalf of petitioner; (3) ordered petitioner's supplies; (4) entered into verbal and/or written agreements on behalf of petitioner; (5) oversaw the finances of petitioner; (6) collected moneys owed petitioner; and (7) managed petitioner. Throughout this period, Graham worked approximately 40 hours per week for petitioner. No other person performed any services on behalf of petitioner.

During 1995, 1996, and 1997, all moneys that were paid on accounts receivable of petitioner were deposited into petitioner's checking account. Petitioner did not make regular payments to Graham for his services. Rather, Graham obtained funds from petitioner's bank account as his needs arose and/or paid personal expenses for himself and his family from such account as he

desired. Petitioner neither classified any payment as a dividend nor distributed any dividends to shareholders from 1995 through 1997.

Petitioner's Tax Reporting

Petitioner timely filed Forms 1120S, U.S. Income Tax Return for an S Corporation, and related schedules for 1991 through 1994. On these returns, petitioner did not report treating Graham, or any other individual, as an employee of petitioner.

Petitioner filed a Form 1120S for each of the years 1995, 1996, and 1997. Petitioner reported ordinary income from its trade or business of $14,261.62, $36,432.45, and $25,380.08 for 1995, 1996, and 1997, respectively. Petitioner claimed no deduction for either compensation of officers or for salaries and wages. Schedules K-1, Shareholder's Share of Income, Credits, Deductions, etc., attached to the returns show the following amounts as the pro rata share of, and as property distribution other than a dividend to, the stockholders:

Stockholder	Amount	Year
Graham and Mrs. Graham	$10,696.21	1995
Graham and Mrs. Graham	27,324.33	1996
Graham	15,228.04	1997
Mrs. Graham	3,807.01	1997
Bethann Graham	3,565.41	1995
Bethann Graham	9,108.12	1996
Bethann Graham	6,345.03	

Petitioner's Forms 1120S were signed by Graham as president and by Joseph M. Grey (Grey) as ppreparer.

During the period from 1995 to 1997, petitioner did not issue any Forms 1099-MISC, Miscellaneous Income, or Forms W-2, Wage and Tax Statement, to Graham. Since petitioner's incorporation in 1991, petitioner has not reported paying Graham a salary or wages for work

he performed on behalf of petitioner.

Petitioner did not file a Form 941, Employer's Quarterly Federal Tax Return, for any qusrter in 1995, 1996, and 1997 or a Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 1995, 1996, and 1997. Throughout this period, petitioner did not treat any individual as an employee.

The Grahams' Tax Reporting

For each of the years 1995, 1996, and 1997, Graham and Mrs. Graham filed a joint Form 1040, U.S. Individual Income Tax Return. On these returns, Graham and Mrs. Graham reported as ordinary income from "Rental real estate, royalties, partnerships, S corporations, trusts, etc." $10,696.21, $27,234.33, and $19,035.05 for 1995, 1996, and 1997, respectively. Attached Schedules E, Supplemental Income and Loss, characterize the foregoing amounts as nonpassive income from Schedules K-1:

The Notice of Determination

Prior to the audit underlying the instant case covering 1995, 1996, and 1997, respondent neither audited petitioner for employment tax purposes nor challenged petitioner's treatment of Graham as other than an employee. Thereafter, on February 23, 2000, respondent sent to petitioner the notice of determination at issue in this proceeding. The notice was based on a determination that Graham was to be legally classified as an employee for purposes of Federal employment taxes and that petitioner was not entitled to relief from such classification pursuant to Sec. 530. Enclosed with the notice was a schedule setting forth petitioner's liabilities for FICA and FUTA taxes.

The parties have stipulated that, if the Court decides that Graham is to be classified as an employee for Federal employment tax purposes for

all periods in 1995, 1996, and 1997, the amounts of taxes due and owing are as set forth in the notice of determination. Conversely, if the Court decides that Graham should not be classified as an employee for any of the periods in issue, the parties agree that petitioner owes no employment taxes.

ULTIMATE FINDINGS OF FACT

Graham, as president of petitioner, performed more than minor services and received remuneration therefor.

Petitioner did not have a reasonable basis for failing to treat Graham as an employee during the years in issue.

OPINION

I. Statutory and Regulatory Provisions

A. Subtitle C of the Internal Revenue Code

Subtitle C of the Internal Revenue Code governs payment of employment taxes. In particular, secs. 3111 and 3301 impose taxes on employees under FICA (pertaining to Social Security) and FUTA (pertaining to unemployment), respecively, based on wages paid to employees. The term "wages" as used in these statutes generally encompasses "all remuneration for employment". Secs. 3121(a), 3306(b), and, with modifications not germane here, sec. 3306(i) makes this definition applicable for purposes of FUTA taxes as well. Sec. 3121(d) provides:

> SEC. 3121(d). Employee. --For purposes of this chapter, the term "employee" means--
>
> (1) any officer of a corporation; or
>
> (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or

(3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person--

(A) as an agent-driver or commission-driver * * *;

(B) as a full-time insurance salesman;

(C) as a home worker * * *; or

(D) as a traveling or city salesman * * *;

* * * [under specified conditions]; or

(4) any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

Regulations promulgated under sec. 3121(d) clarify the scope of the inclusion in paragraph (1) for corporate officers, as follows:

> Generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is considered not to be an employee of the corporation. * * * [Sec. 31.3121(d)-1(b), Employment Tax Regs.]

Identical language is also included in regulations promulgated under sec. 3306. Sec. 31.3306(i)-1(e), Employment Tax Regs..

B. Section 530 of the Revenue Act of 1978

Sec. 530 operates in enumerated circumstances to afford relief from employment tax liability, notwithstanding the actual relationship between the taxpayer and the individual performing services. The statute provides, in part:

SEC. 530. CONTROVERSIES INVOLVING WHETHER INDIVIDUALS ARE EMPLOYEES FOR PURPOSES OF EMPLOYMENT TAXES.

(a) Termination of Certain Employment Tax liability. --

(1) In general. -- if --

(A) For purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and

(B) in the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

(2) Statutory standards providing one method of satisfying the requirements of paragraph (1). --For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

(A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

(B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals

holding positions substantially similar to the position held by this individual; or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

In specified circumstances, Sec. 530(e)(4) places the burden of proof on the Commissioner with respect to certain issues under Sec. 530, but this provision does not affect our analysis here. Sec. 530(e)(4) applies only to periods after December 31, 1996, so has no bearing on petitioner's liabilities for 1995 and 1996. Small Business Job Protection Act of 1996, Pub. L. 104-188, sec. 1122(b)(3), 110 Stat. 1767. For subsequent periods, a taxpayer desiring to take advantage of Sec. 530(e)(4) first must establish a prima facie case that it was reasonable not to treat an individual as an employee and must have fully cooperated with the Secretary. Because, as explained in detail below, petitioner did not establish a prima facie case that its treatment of Graham was reasonable, the burden of proof remains on petitioner with respect to 1997 as well.

II. Classification of Graham for Employment Tax Purposes

A. Status Under FICA and FUTA Provisions

In contending that Graham should not be classified as an employee under the FICA and FUTA provisions of the Internal Revenue Code, petitioner focuses on Graham's status as an S corporation shareholder and alleged lack of status as a common law employee. We briefly address these contentions seriatim.

1. Contentions Regarding S Corporation Shareholders

Petitioner cites secs. 1366, 1372, and 6037(c)

and **Durando v,. United States**, 70 F.3d 548 (9th Cir. 1995), presumably in support of an argument that S corporation shareholders should not be deemed employees. Secs. 1366 and 6037(c) generally require that income items of S corporations be passed through to shareholders on a pro rata basis and reported by such shareholders in a manner consistent with treatment on the corporate return. These rules, however, pertain to calculation of income tax liability under Subtitle A and have no bearing on computation of Federal employment taxes. **Veterinary Surgical Consultants, P.C. v. Commissioner**, 117 T.C. 141, 145 (2001), affd. sub. nom. **Yeagle Drywall Co. v. Commissioner**, 54 Fed. Appx. 100 (3d Cir. 2002). Furthermore, an employer cannot, by the expedient of characterizing moneys paid in remuneration for services as distributions of net income, rather than as wages, avoid FICA and FUTA liabilities. **Id.** at 145-146. Thus, as in **Veterinary Surgical Consultants, P.C. v. Commissioner, supra**, at 145-146, and **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner,** 119 T.C. 121, 128 (2002), we reject any suggestion that petitioner's passing through of its net income to Graham and other shareholders precludes the finding of an employer-employee relationship between petitioner and Graham. We likewise reject as not germane to the question before us petitioner's reliance on sec. 1372, addressing fringe benefits under Sutitle A, and the reference to the statute in **Durando v. United States, supra** at 551. See **Veterinary Surgical Consultants, P.C. v. Commissioner, supra** at 147-148, 150.

2. Contentions Regarding Common Law Employment

Petitioner contends that "employee" as used throughout sec. 3121(d) must be construed in a

manner consistent with its use in sec. 3121(d)(2), such that the usual common law rules for determining existence of an employer-employee relationship are to be taken into account. In support of this position, petitioner quotes the following passage from **Tex. Carbonate Co. v. Phinney**, 307 F.2d 289, 291-292 (5th Cir. 1962):

> The Statutory definition of "employees" as including officers of a corporation will not be so construed as to mean that an officer is an employee per se. Only such officers as work for it in fact are to be so included and, in determining whether an officer is an employee within the meaning of the statutes the usual employer-employee tests are to be applied.
> * * *

Petitioner further emphasizes that common law focuses on whether the alleged employer held the right to control the details of the work performed by the individual and argues that petitioner did not exercise control over Graham during any part of 1995, 1996, and 1997. There exist, however, at least two fatal defects in petitioner's arguments in this regard.

First, from the standpoint of statutory construction, the premise underlying petitioner's position finds no support either in the structure of the text or in the **Tex. Carbonate Co. v. Phinney, supra,** decision. Sec. 3121(d) is written in the disjunctive, with each of the four paragraphs expressly separated from the next by "or". Accordingly, each paragraph affords a separate and independent basis for deeming one engaged to perform services an employee. Individuals described in paragraph (1), (3), and (4) of sec. 3121(d) are therefore frequently referred to as "statutory" employees, subject to FICA and FUTA regardless of their status under common law. See **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner, supra** at 126.

Moreover, **Tex. Carbonate Co. v. Phinney, supra,** is not authority to the contrary. Significant regulatory and statutory developments have occurred since the years in issue in that case. Given that secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs., were promulgated after those years and that the FUTA definition of "employee" then in effect appears to have contemplated a corporate officer who could be an independent contractor under common law, see, e.g., sec. 1607(i), I.R.C. 1939, the Court of Appeals's statements concerning common law rules "may no longer be relevant." **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner, supra** at 128 n.4. The opinion in **Tex. Carbonate Co. v. Phinney, supra** at 291, recognized that, regardless of the test purportedly being applied, "such officers as work fo * * * [a corporation] in fact" are included as employees. The court also addressed the impact of an alleged absence of control in that case, as follows:

> Even though an absence of control is shown, and this as we have noted has not been done, the force of the factor is diminished to near de minimis by the fact that * * * [the service provider] himself was a member of the Board of Directors, a Vice President, and the executive of the Company in charge of its sales and the development of its markets. * * * [**Id.** at 292]

Hence, critical components of the analysis in **Tex. Carbonate, supra,** are consistent with current regulatory approach to officers and contrary to petitioner's position.

Second, from a factual standpoint, even if the common law control factor were pertinent to our evaluation, petitioner has failed to establish a lack of control over Graham in the performance of his services. As in **Joseph M. Grey Pub. Accountant, P.C., supra** at 128-129, to

accept petitioner's contebtions in this regard would be the equivalent of disregarding the corporate form in which Graham chose to conduct his business. Caselaw does not permit a taxpayer to use his or her dual role as a shareholder of and service provider to a corporation as grounds for ignoring the legal ramifications of the business construct so selected. **Moline Props., Inc. v. Commissioner,** 319 U.S. 436, 438-439 (1943); **Joseph M. Grey Pub. Accountant, P.C., supra** at 129.

3. Application of Section 3121(d)(1)

On the basis of the foregoing analysis, application of sec. 3121(d)(1) is not precluded or limited here by considerations pertaining to Graham's status as an S corporation shareholder or under the common law. Sec. 3121(d)(1) and secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs., specify that corporate officers are to be classified as employees if they perform more than minor services and receive or are entitled to receive remuneration. The overwhelming weight of the evidence here shows that Graham's activities vis-a-vis petitioner met these criteria. (Accordingly, considerations with respect to burden of proof do not affect our analysis on this point.) Graham at all relevant times served as petitioner's president and worked approximately 40 hours per week for petitioner in all aspects of petitioner's trucking operations. As Graham testified, he is "a one man band" with respect to petitioner's business activities. Graham also obtained remuneration from petitioner's bank account as his needs arose.

Furthermore, although sec. 3121(d)(1) may be inapplicable to the extent that an officer performs services in some other capacity, i.e., as an independent contractor, petitioner does not contend and offered no evidence that Graham worked for or was engaged by petitioner in a

capacity other than president. See **Joseph M. Grey Pub. Accountant, supra** at 129-130; Rev. Rul. 82-83, 1982-1 C.B. 151, 152. Hence, we conclude that Graham was an employee of petitioner for employment tax purposes, in accordance with sec. 3121(d)(1).

B. Availability of Section 530 Relief

Sec. 530 affords relief from employment tax liability, notwithstanding an adverse classification, where the following three requirements are satisfied: (1) The taxpayer has not treated the individual, or any individual holding a substantially similar position, as an employee for any period; (2) the taxpayer has consistently treated the individual as not being an employee on all tax returns for periods after December 31, 1978; and (3) the taxpayer has a reasonable basis for not treating the individual as an employee. Sec. 530(a)(1), (3). With respect to the case at bar, respondent has conceded that petitioner meets the first of the above requirements and does not argue that petitioner fails to meet the second. Rather, the parties dispute whether petitioner had a reasonable basis for not treating Graham as an employee.

Concerning the existence of a reasonable basis for purposes of sec. 530(a)(1), sec. 530(a)(2) sets forth three statutory safe havens. Reliance upon any of the circumstances enumerated in subparagraphs (A), (B), or (C) of sec. 530(a)(2) is deemed sufficient to establish the requisite reasonable basis.

Subparagraph (A) lists judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer. The second amended petition alleges:

> The Petitioner relies on judicial precedent in satisfaction of the provisions of the said Section 530 which establishes reasonable basis for Petitioner's treatment of its majority shareholder and president, Michael J. Graham,

> as a non-employee during all times and all years * * *; the said judicial precedent relied on by Petitioner is **Texas Carbonate Company v. R.L.Phinney**, 307 F.2d 289 (5th Cir.), **cert. denied**, 371 U.S. 940 (1962).

On brief, petitioner reiterates reliance on **Tex. Carbonate Co., supra**, and cites as well to **Automated Typesetting, Inc. v. United States**, 527 F.Supp. 515 (E.D. Wis. 1981), in support of the premise that petitioner reasonably looked to common law control concepts in classifying Graham.

For the reasons previously discussed, **Tex. Carbonate Co., supra**, does not afford a reasonable basis for disregard of the explicit rules of sec. 3121(d)(1) and secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs.. Equally unavailing in this regard is **Automated Typesetting, Inc., supra.** The District Court in that case simply evaluated the employment relationship of the involved individuals both through a common law analysis and through application of the provisions relating to corporate officers. **Id.** at 519-522. In deciding that the individuals qualified as employees under either rubric, the court did not repudiate the statutory treatment of corporate executives. **Id.** at 520, 522; see also **Joseph M. Grey Pub. Accountant, P.C., supra** at 129 n.5.

Moreover, even if we were to assume arguendo that the cited cases could afford a reasonable basis for treating an officer as a nonemployee, petitioner has failed to establish reliance on the claimed precedent as a factual matter. To fall within the safe harbors of Sec. 530(a)(2), the taxpayer must have relied on the alleged authority during the periods in issue, at the time the employment decisions were being made. The statute does not coutenance ex post facto justification. See **303 W. 42nd St. Enters.,**

Inc. v. IRS, 181 F.3d 272, 277, 279 (2d Cir. 1999) (reversing and remanding because it was "unclear from the record whether * * * [the taxpayer] in fact relied on any specific industry practice in reaching its decision to treat its * * * [workers] as non-employee tenants, let alone whether such reliance was reasonable"); **Select Rehab. Inc. v. United States**, 205 F.Supp. 2d 376, 380 (M.D. Pa. 2002) ("The taxpayer must show that it relied upon those grounds [alleged as a reasonable basis], and that the reliance was reasonable."); **W. Va. Pers. Servs., Inc. v. United States**, 78 AFTR 2d 96-6600, at 96-6608, 96-2 USTC par. 50,554, at 85,919 (S.D. W. Va. 1996) ("The plain meaning of sec. 530(a)(2) is that only evidence known to and relied upon by the taxpayer is relevant. Facts that are learned after the incorrect treatment of the employees * * * are not facts a taxpayer relied upon in making its original decision regarding how to treat its employees.")

Until shortly before trial, petitioner did not purport to rely on Sec. 530 or the bases described therein and expressly disclaimed any dependence on the statute. Petitioner's present claim of reliance is not credible. The following colloquy transpired at trial between Graham and counsel for respondent:

> Q [Counsel for respondent] It's my understanding that petitioner is contending that it relied on Texas Carbonate versus Phinney as the basis for treating you as other than an employee. Is that correct?
>
> A [Graham] I don't know nothing about this. I don't know.
>
> Q You're not familiar with the case Texas Carbonate versus Phinney?
>
> A No.
>
> Q Dis you ever talk to anyone about this case?

A No.

Petitioner proposed to call Grey, the accountant who advised petitioner and prepared petitioner's tax returns. Grey was not allowed to testify in this case because he had not been listed as a witness in petitioner's trial memorandum, in violation of this Court's standing Pre-Trial Order. See Rule 131(b). His testimony in any event, would not have made a difference. See **Veterinary Surgical Consultants, P.C. v. Commissioner**, T.C. Memo 2003-48 (where Grey testified that he was unaware of the **Tex. Carbonate Co., supra**, case until posttrial briefing, during the fall of 2001, in **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. 121 (2002)). Petitioner failed to establish that it relied on judicial precedent or, for that matter, on any of the other sources specified in sec. 530(a)(2)(A). Accordingly, we conclude that subparagraph (A) does not aid petitioner here.

The same result obtains with respect to subparagraphs (B) and (C). The parties have stipulated that respondent did not audit petitioner for employment tax purposes prior to the examination underlying the present case. Petitioner therefore cannot show reliance on a past audit under Sec. 530(a)(2)(B). Likewise, petitioner has adduced no evidence of conventions in the trucking industry to establish longstanding industry practice under sec. 530(a)(2)(C). The safe havens of sec. 530(a)(2) are therefore inapplicable on the record before us.

In seeking to establish a reasonable basis for Graham's treatment apart from the safe havens, petitioner quotes the following definition of "employment status" in sec. 530(c)(2): "The term "employment status" means the status of an individual, under the usual common law rules applicable in determining the employer-employee

relationship, as an employee or as an independent contractor (or other individual who is not an employee)." Petitioner apparently believes that the purported lack of common law control makes its treatment of Graham reasonable within the meaning of sec. 530 and that the above definition supports this view.

Again, however, petitioner's approach is contrary to controlling statutes and to the facts of this case. As a matter of construction, sec. 530(c)(2) defines employment status for purposes of certain provisions of sec. 530 not germane here. It does not purport to override or interpret the definition of "employee" in sec. 3121(d)(1) and related regulations. Hence, sec. 530(c)(2) does not render it rational for Home-Office is principal place of business to have ignored the statutory mandate regarding corporate officers and to have taken a position that was not otherwise supported by authority. Petitioner also does not claim in actuality to have relied on sec. 530(c)(2) in deciding not to treat Graham as an employee in 1995, 1996, and 1997. We conclude and have found as a fact that petitioner did not have a reasonable basis for failing to characterize Graham as an employee. Consequently, relief from employment tax liability is not available to petitioner under sec. 530.

C. Conclusion

We hold that Graham is an employee of petitioner pursuant to sec. 3121(d)(1) and that petitioner is not entitled to relief under sec. 530. Accordingly, petitioner is liable for FICA and FUTA taxes for the periods in issue as set forth in respondent's notice of determination and the parties' stipulations.

To reflect the foregoing,

Decision will be entered for respondent and in accordance with the parties stipulations as to amounts.

UNITED STATES TAX COURT
Washington, D.C. 20217

MIKE J. GRAHAM TRUCKING, INC.,	)	
Petitioner	)	
v.	)	Docket No. 4799-00
COMMISSIONER OF INTERNAL REVENUE,	)	EMPLOYMENT
Respondent	)	

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion (T.C. Memo. 2003-49) filed February 26, 2003, it is hereby

ORDERED AND DECIDED: That Michael J. Graham is classified as an employee of petitioner for purposes of Federal employment taxes under Subtitle C of the Internal Revenue Code with respect to the taxable quarters ended March 31 1995; June 30, 1995; September 30, 1995; December 31, 1995; March 31, 1996; June 30, 1996; September 30, 1996; December 31; 1996; March 31, 1997; June 30, 1997; September 30, 1997; December 31, 1997.

That petitioner is not entitled to relief under Section 530 of the Revenue Act of 1978 with respect to Michael J. Graham.

That the proper amounts of employment tax under the above determination are as shown below:

Federal Insurance Contributions Act (FICA)Tax Imposed Under I.R.C. Secs. 3101, 3102(a), and 31111

Tax Period Ended	Amount of Tax
Mar. 31, 1995	$ 546
June 30, 1995	546
Sept. 30, 1995	546
Dec. 31, 1995	546
Mar. 31, 1996	1,394
June 30, 1996	1,394
Sept. 30, 1996	1,394
Dec. 31, 1996	1,394
Mar. 31, 1997	971
June 30, 1997	971
Sept. 30, 1997	971
Dec. 31, 1997	971

Federal Unemployment Tax Act (FUTA) Tax Imposed Under I.R.C. Sec. 3301

Tax Period Ended	Amount of Tax
Dec. 31, 1995	$ 434
Dec. 31, 1996	434
Dec. 31, 1997	434

/s/ Mary Ann Cohen

Judge

Entered: MAR 10 2003

T,C. Memo. 2003-53

UNITED STATES TAX COURT

WATER-PURE SERVICES, INC.,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 11344-01 Filed February 26, 2003.

Joseph H. O'Donnell, Jr., for petitioner.

W. Randolph Shump and Pamela J. Arthur-Gerlach, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COHEN, Judge: The petition in this case was filed in response to a Notice of Determination Concerning Worker Classification Under Section 7436 (notice of determination) regarding petitioner's liabilities pursuant to the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) for 1996, 1997, and 1998. The issues for decision are (1) Whether Martin L. Ridge (Ridge) was an employee of petitioner for Federal employment tax purposes during 1996 through 1998 and, if so, (2) whether petitioner is entitled to relief under section 530 of the Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2885, as amended (sec. 530).

Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure. For convenience, FICA and FUTA taxes are collectively referred to as employment taxes.

FINDINGS OF FACT

The facts in this matter were deemed stipulated pursuant to Rule 91(f). The stipulated facts are incorporated in our findings by this reference.

Petitioner's Organization and Operations

Petitioner was incorporated in Pennsylvania on July 19, 1985, and has at all relevant times operated as an S corporation. Petitioner's principal place of business was located in Langhorne, Pennsylvania, at the address of Ridge's personal residence, when the petition was filed in this case.

Since its organization and through the years in issue, petitioner provided sales and service of water purification systems. This activity was petitioner's only business and only source of income. Ridge and his wife, Jean S. Ridge (Mrs. Ridge), each owned 50 percent of petitioner from the time of its incorporation and throughout 1996, 1997, and 1998.

During 1996, 1997, and 1998, petitioner did not make regular payments at fixed times to Ridge for his services. Rather, Ridge received funds from petitioner as his needs arose. Petitioner neither classified any payment as a dividend nor distributed any dividends to shareholders from 1996 through 1998.

Petitioner's Tax Reporting

Petitioner timely filed Forms 1120S, U.S. Income Tax Return for an S Corporation, and related schedules, for each of the years 1996, 1997, and 1998. Petitioner reported ordinary income from its trade or business of $26,173.32, $17,052.98, and $4,822.46 for 1996, 1997, and 1998, respectively. Petitioner claimed no deduction either for compensation of officers or for salaries and wages in 1996; for 1997 and 1998, petitioner's returns reflect deductions of

$16,500 and $14,000, respectively, for compensation of officers. Schedules K-1, Shareholder's Shareof Income, Credits, Deductions, etc., attached to the returns show the following amounts as the pro rata share of, and as a property distribution other than a dividend to, the stockholders:

Shareholder	Year	Amount
Ridge and Mrs. Ridge	1996	$26,173.32
Ridge	1997	8,526.49
Ridge	1998	2,411.23
Mrs. Ridge	1997	8,526.49
Mrs. Ridge	1998	2,411.23

Petitioner's Forms 1120S were signed by Ridge as president and by Joseph M. Grey (Grey) as preparer.

During the period from 1996 to 1998, petitioner did not issue any Forms W-2, Wage and Tax Statement, to Ridge. Petitioner also did not issue any Forms 1099-MISC, Miscellaneous Income, to Ridge for 1996. For 1997 and 1998, petitioner issued Forms 1099-MISC to Ridge reporting respective payments of $16,500 and $20,000.

Petitioner did not file a Form 941, Employer's Quarterly Federal Tax Return, for any quarter in 1996, 1997, and 1998 or a Form 940, Employer's Annual Federal Unemployment ((FUTA) Tax Return for 1996, 1997, and 1998.

The Ridges' Tax Reporting

For each of the years 1996, 1997, and 1998, the Ridges timely filed a joint Form 1040, U.S. Individual Income Tax Return. On these returns, the Ridges reported as ordinary income from "Rental real estate, royalties, partnerships, S corporations, trusts, etc." $26,173.32 for 1996 and $23,052.98 for 1997. (Equivalent information for 1998 is unavailable because the copy of the 1998 return contained in the record does not include the

first two pages.) For 1996, an attached Schedule E, Supplemental Income and Loss, characterizes the foregoing amount as nonpassive income from Schedule K-1. For 1997, $17,052.98 is shown on Schedule E as nonpassive income from Schedules K-1; $6,000 is shown on Schedule E and on Form 4831, Rental Income, as rent; and $16,500 is shown on Schedule C, Profit of Loss From Business, as gross receipts. For 1998, $4,822.46 is shown on Schedule E as nonpassive income from Schedules K-1, $6,000 is shown on Schedule E and on Form 4831 as rent, and $14,000 is shown on Schedule C as gross receipts.

The Notice of Determination

On June 8, 2001, respondent sent to petitioner the notice of determination at issue in this proceeding. The notice was based on a determination that Ridge was to be legally classified as an employee for purposes of Federal employment taxes and that petitioner was not entitled to relief from such classification pursuant to Section 530. Enclosed with the notice was a schedule setting forth petitioner's liabilities for FICA and FUTA taxes.

In calculating petitioner's FICA and FUTA liabilities, respondent concluded that only Ridge (and not Mrs. Ridge) provided services to petitioner during the years in issue and, accordingly, limited the computation to amounts distributed to Ridge. As a result, for each of the years 1996, 1997, and 1998, respondent classified as wages to Ridge 50 percent of the nonpassive income distributed by petitioner. For 1997 and 1998, respondent also reclassified as wages the Form 1099-MISC "nonemployee compensation" paid to Ridge.

It is stipulated that, if the Court decides that Ridge is to be classified as an employee for Federal employment tax purposes for all periods in 1996, 1997, and 1998, the amounts of taxes due and owing are as set forth in the notice of

determination.

ULTIMATE FINDINGS OF FACT

Ridge, as president of petitioner, performed more than minor services and received remuneration therefor.

Petitioner did not have a reasonable basis for failing to treat Ridge as an employee during the years in issue.

OPINION

I. Statutory and Regulatory Provisions

A. Subtitle C of the Internal Revenue Code

Subtitle C of the Internal Revenue Code governs payment of employment taxes. In particular, secs. 3111 and 3301 impose taxes on employers under FICA (pertaining to Social Security) and FUTA (pertaining to unemployment), respectively, based on wages paid to employees. The term "wages" as used in these statutes generally encompasses "all remuneration for employment". Secs. 3121(a), 3306(b). "Employee" is defined for purposes of FICA taxes in sec. 3121(d), and with modifications not germane here, sec. 3306(i) makes this definition applicable for purposes of FUTA as well. Sec. 3121(d) provides:

> SEC. 3121(d). Employee.--For purposes of this chapter, the term "employee" means--
>
> (1) any officer of a corporation; or
>
> (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or
>
> (3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person--
>
> (A) as an agent-driver or commission-driver * * *;

(B) as a full-time insurance salesman;

(C) as a home worker * * *; or

(D) as a traveling or city salesman * * *;

* * * [under specified conditions]; or

(4) any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

Regulations promulgated under sec. 3121(d) clarify the scope of the inclusion in paragraph (1) for corporate officers, as follows:

Generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is considered not to be an employee of the corporation. * * * [sec. 31.3121(d)-1(b), Employment Tax Regs.]

Identical language is also included in regulations promulgated under sec. 3306. Sec. 31.3306(i)-1(e), Employment Tax Regs..

B. Section 530 of the Revenue Act of 1978

Section 530 operates in enumerated circumstances to afford relief from employment tax liability, notwithstanding the actual relationship between the taxpayer and the individual performing services. The statute provides, in part:

SEC. 530. CONTROVERSIES INVOLVING WHETHER INDIVIDUALS ARE EMPLOYEES FOR PURPOSES OF THE EMPLOYMENT TAXES.

(a) Termination of Certain Employment Tax Liability.--

(1) In general.--if--

(A) for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and

(B) in the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then, for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

(2) Statutory standards providing one method of satisfying the requirements of paragraph (1).--For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

(A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

(B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

In specified circumstances, sec. 530(e)(4) places the burden of proof on the Commissioner with respect to certain issues under sec. 530, but this provision does not affect our analysis here. Sec. 530(e)(4) applies only to periods after December 31, 1996, so has no bearing on petitioner's liabilities for 1996. Small Business Job Protection Act of 1996, Pub. L. 104-188, sec. 1122(b)(3), 110 Stat. 1767. For subsequent periods, a taxpayer desiring to take advantage of sec. 530(e)(4) first must establish a prima facie case that it was reasonable not to treat an individual as an employee and must have fully cooperated with the Secretary. Because, as explained in detail below, petitioner did not establish a prima facie case that its treatment of Ridge was reasonable, the burden of proof remains on petitioner with respect to 1997 and 1998 as well.

II. Classification of Ridge for Employment Tax Purposes

A. Status Under FICA and FUTA Provisions

In contending that Ridge should not be classified as an employee under the FICA and FUTA provisions of the Internal Revenue Code, petitioner focuses on Ridge's status as an S corporation shareholder and alleged lack of status as a common law employee. We briefly address these contentions seriatim.

1. Contentions Regarding S Corporation Shareholders

Petitioner cites secs. 1366, 1372, and 6037(c) and **Durando v. United States**, 70 F.3d 548 (9th Cir. 1995), presumably in support of an argument that S corporation shareholders should not be deemed employees. Secs. 1366 and 6037(c) generally require that income items of S corporations be passed through to shareholders on

a pro rata basis and reported by such shareholders in a manner consistent with treatment on the corporate return. These rules, however, pertain to calculation of income tax liability under subtitle A and have no bearing on computation of Federal employment taxes. **Veterinary Surgical Consultants, P.C. v. Commissioner**, 117 T.C. 141, 145 (2001), affd. sub nom. **Yeagle Drywall Co. v. Commissioner**, 54 Fed. Appx. 100 (3d Cir. 2002). Furthermore, an employer cannot, by the expedient of characterizing moneys paid in remuneration for services as distributions of net income, rather than as wages, avoid FICA and FUTA liabilities. **Id.** at 145-146. Thus, as in **Veterinary Surgical Consultants, P.C., supra** at 145-146, and **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. 121, 128 (2002), we reject any suggestion that petitioner's passing through of its net income to shareholders precludes the finding of an employer-employee relationship between petitioner and Ridge. We likewise reject as not germane to the question before us petitioner's reliance on sec. 1372, addressing fringe benefits under subtitle A, and the reference to that statute in **Durando, supra** at 551. See **Veterinary Surgical Consultants, P.C., supra** at 147-148, 150.

2. Contentions Regarding Common Law Employment

Petitioner contends that "employee" as used throughout sec. 3121(d) must be construed in a manner consistent with its use in sec. 3121(d)(2), such that the usual common law rules for determining existence of an employer-employee relationship are to be taken into account. In support of this position, petitioner quotes the following passage from **Tex. Carbonate Co. v. Phinney**, 307 F.2d 289, 291-292 (5th Cir. 1962):

> The statutory definition of "employee" as including officers of a corporation will not be so construed as to mean that an officer is an employee per se. Only such officers as work for it in fact are to be so included and, in determining whether an officer is an employee within the meaning of the statutes the usual employer-employee tests are to be applied. * * *

Petitioner further emphasizes that common law focuses on whether the alleged employer held the right to control the details of the work performed by the individual and argues that petitioner had neither the authority nor the ability to exert control over Ridge. There exist, however, at least two fatal defects in petitioner's arguments in this regard.

First, from the standpoint of statutory construction, the premise underlying petitioner's position finds no support either in the structure of the text or in the **Tex. Carbonate Co., supra,** decision. Sec. 3121(d) is written in the disjunctive, with each of the four paragraphs expressly separated from the next by "or". Accordingly, each paragraph affords a separate and independent basis for deeming one engaged to perform services as an employee. Individuals described in paragraphs (1), (3), and (4) of sec. 3121(d) are therefore frequently referred to as "statutory" employees, subject to FICA and FUTA regardless of their status under common law. See **Joseph M. Grey Pub. Accountant, P.C., supra** at 126.

Moreover, **Tex. Carbonate Co., supra**, is not authority to the contrary. Significant regulatory and statutory developments have occurred since the years in issue in that case. Given that secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs., were promulgated after those years and that the FUTA definition of "employee" then in effect

appears to have contemplated a corporate officer who could be an independent contractor under common law. see, e.g., sec. 1607(i), I.R.C. 1939, the Court of Appeals' statements concerning common law rules "may no longer be relevant." **Joseph M. Grey Pub. Accountant, P.C., supra** at 128 n.4. The opinion in **Tex. Carbonate Co., supra** at 291, recognized that, regardless of the test purportedly being applied, "such officers as work for * * * [a corporation] in fact" are included as employees. The court also addressed the impact of an alleged absence of control in that case, as follows:

> Even though an absence of control is shown, and this as we have noted has not been done, the force of the factor is diminished to near de minimis by the fact that * * * [the service provider] himself was a member of the Board of Directors, a Vice President, and the executive of the Company in charge of its sales and the development of its markets. * * * [**Id.** at 292].

Hence, critical components of the analysis in **Tex. Carbonate Co., supra**, are consistent with the current regulatory approach to officers and contrary to petitioner's position.

Second, from a factual standpoint, even if the common law control factor were pertinent to our evaluation, petitioner has failed to establish a lack of control over Ridge in the performance of his services. As in **Joseph M. Grey Pub. Accountant, P.C., supra** at 128-129, to accept petitioner's contentions in this regard would be the equivalent of disregarding the corporate form in which Ridge chose to conduct his business. Caselaw does not permit a taxpayer to use his or her dual role as a shareholder of and service provider to a corporation as grounds for ignoring the legal ramifications of the business construct so

selected. **Moline Props., Inc. v. Commissioner**, 319 U.S. 436, 438-439 (1943); **Joseph M. Grey Pub. Accountant, P.C., supra**, at 129

3. Application of Section 3121(d)(1)

On the basis of the foregoing analysis, application of sec. 3121(d)(1) is not precluded or limited here by considerations pertaining to Ridge's status as an S corporation shareholder or under the common law. Sec. 3121(d)(1) and secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs., specify that corporate officers are to be classified as employees if they perform more than minor services and receive or are entitled to receive remuneration. The overwhelming weight of the evidence here shows that Ridge's activities vis-a-vis petitioner met these criteria. (Accordingly, considerations with respect to burden of proof do not affect our analysis on this point.) Ridge at all relevant times served as petitioner's president and worked in all significant aspects of petitioner's business operations. Ridge also obtained remuneration from petitioner as his needs arose.

Furthermore, although sec. 3121(d)(1) may be inapplicable to the extent that an officer performs services in some other capacity, i.e., as an independent contractor, petitioner has offered no convincing evidence that Ridge worked for or was engaged by petitioner in a capacity other than as president. See **Joseph M. Grey Pub. Accountant, P.C., supra** at 129-130; Rev. Rul. 82-83, 1982-1 C.B. 151, 152. The only items referenced in the record that could suggest an independent contractor relationship are Forms 1099-MISC reporting nonemployee compensation. Those documents are uncorroborated by other evidence, such as a service agreement, and are entitled to little weight. See **Joseph M. Grey Pub. Accountant, P.C., supra**, at 130.

Hence, we conclude that Ridge was an employee of petitioner for employment tax purposes, in accordance with sec. 3121(d)(1).

B. Availability of Section 530 Relief

Sec. 530 affords relief from employment tax liability, notwithstanding an adverse classification, where the following three requirements are satisfied: (1) the taxpayer has not treated the individual, or any individual holding a substantially similar position, as an employee for any period; (2) the taxpayer has consistently treated the individual as not being an employee on all tax returns for periods after December 31, 1978; and (3) the taxpayer has a reasonable basis for not treating the individual as an employee. Sec. 530(a)(1), (3).

With respect to the case at bar, petitioner did not claim entitlement to the benefits of Sec. 530 until posttrial briefing. Generally, issues raised for the first time on brief will not be considered when to do so would prevent the opposing party from presenting evidence that might have been offered if the issue had been timely raised. **DiLeo v. Commissioner**, 96 T.C. 858, 891 (1991), affd. 959 F.2d 16 (2d Cir. 1992); **Shelby U.S. Distribs., Inc. v. Commissioner**, 71 T.C. 874, 885 (1979). Here, however, even if we were to treat the issue as properly before us, petitioner's position is without merit. It is clear that petitioner failed to establish a reasonable basis for not treating Ridge as an employee.

Concerning the existence of a reasonable basis for purposes of sec. 530(a)(1), sec. 530(a)(2) sets forth three statutory safe havens. Reliance upon any of the circumstances enumerated in paragraph (A), (B), or (C) of sec. 530(a)(2) is deemed sufficient to establish the requisite reasonable basis.

Subparagraph (A) lists judicial precedent, published rulings, technical advice with respect

to the taxpayer, or a letter ruling to the taxpayer. On brief, petitioner cites **Tex. Carbonate Co., supra,** and **Automated Typesetting, Inc. v. United States,** 527 F.Supp. 515 (E.D. Wis. 1981), in support of the premise that petitioner reasonably looked to common law control concepts in classifying Ridge.

For the reasons previously discussed, **Tex. Carbonate Co., supra,** does not afford a reasonable basis for disregard of the explicit rules of sec. 3121(d)(1) and secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs.. Equally unavailing in this regard is **Automated Typesetting, Inc., supra.** The District Court in that case simply evaluated the employment relationship of the involved individuals both through a common law analysis and through application of the provisions relating to corporate officers. **Id.** at 519-522. In deciding that the individuals qualified as employees under either rubric, the court did not repudiate the statutory treatment of corporate executives. **Id.** at 520-522; see also **Joseph M. Grey Pub. Accountant, P.C., supra** at 129 n.5.

Moreover, even if we were to assume arguendo that the cited cases could offer a reasonable basis for treating an officer as a nonemployee, petitioner has failed to establish reliance on the claimed precedent as a factual matter. To fall within the safe harbors of sec. 530(a)(2), the taxpayer must have relied on the alleged authority during the periods in issue, at the time the employment decisions were being made. The statute does not countenance ex post facto justification. See **303 W. 42nd St. Enters., Inc. v. IRS,** 181 F.3d 272, 277, 279 (2d Cir. 1999) (reversing and remanding because it was "unclear from the record whether * * * [the taxpayer] in fact relied on any specific industry practice in reaching its decision to treat its * * * [workers] as non-employee tenants, let alone

whether such reliance was reasonable"); **Select Rehab., Inc. v. United States**, 205 F. Supp. 2d 376, 380 (M.D. Pa. 2002) ("The taxpayer must show that it relied upon those grounds [alleged as a reasonable basis], and that the reliance was reasonable."); **W. Va. Pers. Servs., Inc. v. United States**, 78 AFTR 2d 96-6600, at 96-6608, 96-2 USTC par. 50,554. at 85,919 (S.D. W. Va. 1996) ("The plain meaning of section 530(a)(2) is that only evidence known to and relied upon by the taxpayer is relevant. Facts that are learned after the incorrect treatment of the employees * * * ar net facts that a taxpayer relied upon in making its original decision regarding how to treat its employees.")

Until after trial, petitioner did not purport to rely on sec. 530 or the bases described therein and expressly disclaimed any dependence on the statute. Petitioner's present claim of reliance is not credible. At trial, Ridge appeared but presented no evidence regarding petitioner's rationale for the nonemployee treatment. Nor would testimony by Grey, the accountant who advised petitioner and prepared petitioner's tax returns, have provided any further justification. See **Veterinary Surgical Consultants, P.C. v. Commissioner**, T.C. Memo 2003-48 (where Grey testified that he was unaware of the **Tex. Carbonate Co., supra,** case until posttrial briefing, during the fall of 2001, in **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. 121 (2002)). Petitioner failed to establish that it relied on judicial precedent or, for that matter, on any of the other sources specified in sec. 530(a)(2)(A). Accordingly, we conclude that subparagraph (A) does not aid petitioner here.

The same result obtains with respect to subparagraphs (B) and (C). There is no evidence that respondent audited petitioner for employment tax purposes prior to the examination underlying

the present case. Petitioner therefore cannot show reliance on a past audit under sec. 530(a)(2)(B). Likewise, petitioner has adduced no evidence of conventions in the water filtration and purification industry to establish longstanding industry practice under sec. 530(a)(2)(C). The safe havens of sec. 530(a)(2) are therefore inapplicable on the record before us.

In seeking to establish a reasonable basis for Ridge's treatment apart from the safe havens, petitioner quotes from the following definition of "employment status" in sec. 530(c)(2): "The term "employment status" means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an employee)." Petitioner apparently believes that the purported lack of common law control makes its treatment of Ridge reasonable within the meaning of sec. 530 and that the above definition supports this view.

Again, however, petitioner's approach is contrary to controlling statutes and to the facts of this case. As a matter of construction, sec. 530(c)(2) defines employment status for purposes of vertain provisions of sec. 530 not germane here. It does not purport to override or interpret the definition of "employee" in sec. 3121(d) and related regulations. Hence, sec. 530(c)(2) does not render it rational for petitioner to have ignored the statutory mandate regarding corporate officers and to have taken a position that was not otherwise supported by authority. Petitioner also does not claim in actuality to have relied on sec. 530(c)(2) in deciding not to treat Ridge as an employee in 1996, 1997, and 1998. We concl de and have found as a fact that petitioner did not have a reasonable basis for failing to characterize

Ridge as an employee. Consequently, relief from employment tax liability is not available to petitioner under sec. 530.

Lastly, in connection with sec. 530, petitioner raises a due process argument. Sec. 530(e)(1) provides that the Internal Revenue Service "shall, before or at the commencement of any audit inquiry relating to the employment status of one or more individuals who perform services for the taxpayer, provide the taxpayer with a written notice of the provisions of this section." Small Business Job Protection Act of 1996 sec. 1122(a), 110 Stat. 1776. On brief,, petitioner alleges that it learned of the existence of sec. 530 only through the June 8, 2001, notice of determination, which postdated by a substantial margin the commencement on July 1, 199, of the underlying employment tax audit. Petitioner states:

> The inaction of Respondent in not providing Petitioner with the required Sect. 530(e)(1) notice constitutes a serious Constitutional violation of due process rights guaranteed to Petitioner, and Petitioner moves this Court to allow it to recover its legal fees, since the conduct against Petitioner by Respondent is so egregious.

To the extent that petitioner's due process contentions take the form of a claim for litigation or administrative costs and fees under sec. 7430, such claim is premature. Rule 231(a)(2), as pertinent here, specifies that the appropriate time to seek recovery of legal costs follows service of a written opinion. See **McWilliams v. Commissioner**, 104 T.C. 320, 327 (1995); **Groetzinger v. Commissioner**, 87 T.C. 533, 548 (1986).

Furthermore, even if petitioner's allegations might be read as a plea encompassing other

remedies, petitioner has failed to show that its situation satisfies the prerequisites for relief under the Due Process Clause. As this Court has noted, even in a criminal context defendants are generally required to establish actual prejudice in order to obtain due process relief. **Riland v. Commissioner**, 79 T.C. 185, 197-198 (1982) (involving a claimed denial of due process on account of delay in issuance of the subject deficiency notice). The record in the instant case is devoid of such prejudice. Although petitioner was made aware of sec. 530 at least prior to filing its petition with the Court, petitioner failed therein to raise the statute. Petitioner then did nothing to prepare this case for trial. Nonetheless, we have addressed the merits of petitioner's claim for relief under sec. 530(a), first put forth 3 months after trial, despite the untimeliness of petitioner's contentions. Accordingly, petitioner was afforded an opportunity to be heard, and no actual prejudice was sustained.

C. Conclusion

We hold that Ridge is an employee of petitioner pursuant to sec. 3121(d)(1) and that petitioner is not entitled to relief under sec. 530. Accordingly, petitioner is liable for FICA and FUTA taxes for the periods in issue as set forth in respondent's notice of determination and relevant stipulations.

To reflect the foregoing,

Decision will be entered for respondent and in accordance with stipulations as to amounts.

UNITED STATES TAX COURT
Washington, D.C. 20217

WATER-PURE SYSTEMS, INC., Petitioner	)	
v.	)	Docket No. 11344-01
COMMISSIONER OF INTERNAL REVENUE, Respondent	)	EMPLOYMENT

DECISION

Pursuant to the determination of the Court as set forth in the Memorandum Findings of Fact and Opinion (T.C. Memo. 2003-53) Filed February 26, 2003, it is hereby

ORDERED and DECIDED: That Martin L. Ridge is classified as an employee of petitioner for purposes of Federal employment taxes under Subtitle C of the Internal Revenue Code with respect to the taxable quarters ended March 31, 1996; June 30, 1996; September 30, 1996; December 31, 1996; March 31, 1997; June 30, 1997; September 30, 1997; December 31. 1997; March 31, 1998; June 30, 1998; September 30, 1998; and December 31, 1998.

That petitioner is not entitled to relief under Section 530 of the Revenue Act of 1978 with respect to Martin L. Ridge.

That the proper amounts of employment tax under the above determination are as shown below:

Federal Insurance Contributions Act (FICA) Tax Imposed Under Secs. 3101, 3102(a), and 3111

Tax Period Ended	Amount of Tax
Mar. 31, 1996	$ 500
June 30, 1996	501
Sept. 30, 1996	501
Dec. 31, 1996	501
Mar. 31, 1997	892
June 30, 1997	892
Sept. 30, 1997	892
Dec. 31, 1997	892
Mar. 31, 1998	466
June 30, 1998	466
Sept. 30, 1998	466
Dec. 31, 1998	466

Federal Unemployment Tax Act (FUTA) Tax Imposed Under I.R.C. Sec. 3301

Tax Period Ended	Amount of Tax
Dec. 31, 1996	$ 434
Dec. 31, 1997	434
Dec. 31, 1998	434

/s/ Mary Ann Cohen
Judge

Entered: MAR 10 2003

NOT PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 03-2755

SUPERIOR PROSIDE, INC.,
Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

On Appeal From the United States Tax Court
(Tax Court No. 00-04804)
Tax Court Judge: Honorable Mary Ann Cohen

Submitted Pursuant to Third Circuit
LAR 34.1(a) (2002)
January 12, 2004

Before: ALITO, CHERTOFF and BECKER,
Circuit Judges.

(Filed: January 28, 2004)

OPINION OF THE COURT

BECKER, Circuit Judge.

This is an appeal by Superior Proside, Inc. ("taxpayer") from a decision of the United States Tax Court following a proceeding for redetermination of a Notice of Determination Concerning Worker Classification Under Section 7436 of the Internal Revenue Code. The issue

tried by Judge Cohen was whether Thomas L. Murdock, the taxpayer's sole shareholder and president, was an employee of taxpayer during 1995, 1996, and 1997 for purposes of federal employment taxes. Judge Cohen filed a memorandum opinion, 85 T.C.M.(CCH)914(2003), upholding the Commissioner's determination that Murdock was an employee of taxpayer and that taxpayer therefore was subject to federal employment taxes with respect to the wages paid to Murdock. We will affirm.

The facts are not in dispute. Taking taxpayer's version of the facts:

> Mr. Murdock owned one-hundred percent (100%) of [taxpayer's] stock in all years from 1987 to the present, including 1995, 1996, and 1997. Mr. Murdock also assumed the title of president, vice president, secretary, treasurer, chairman of the board of directors and director of [taxpayer] from 1987 to the present, including all during 1995, 1996, and 1997. Mr. Murdock totally controlled and managed all the business activities of [taxpayer] at all times in [taxpayer's] existence, including all during 1995, 1996, and 1997. No person ever controlled Mr. Murdock in the performance of his work for [taxpayer].

Embellishing upon this description, the Commissioner points out that:

> During the period at issue (1995, 1996, and 1997), Mr. Murdock performed the following services for taxpayer:
>
> 1. Solicited business on behalf of taxpayer;
> 2. Ordered taxpayer's supplies;
> 3. Entered into verbal and/or written agreements on behalf of taxpayer;
> 4. Oversaw the finances of taxpayer;

5. Collected moneys owed taxpayer;
6, Managed taxpayer;
7. Obtained clients for taxpayer;
8. Hired and fired independent contracts on behalf of taxpayer;
9. Maintained customer satisfaction;
10. Supervised all work done on behalf of taxpayer.

During 1995, 1996, and 1997, the taxpayer did not make regular payments to Murdock for his services; rather Murdock would take money from taxpayer as his needs arose to pay personal expenses. Taxpayer did not distribute any dividend to any shareholder during 1995, 1996, and 1997, and taxpayer did not classify any payment made to Murdock as a dividend. On its Forms 1120S (Income Tax Return for an S Corporation), taxpayer reported net income from its trade or business for 1995, 1996, and 1997, in the respective amounts of $29,671, $29402 and $41,688. In calculating those amounts of ordinary income, taxpayer claimed no deductions for either compensation of officers or salaries and wages. The returns are signed by Murdock, as president of taxpayer, and by Joseph Grey, as the tax return preparer.

During 1995 through 1997 taxpayer did not issue any Forms 1099-MISC (Miscellaneous Income) or Forms W-2 (Wage and Tax Statement) to Murdock. Moreover, since taxpayer's incorporation in 1987, taxpayer has not reported paying Murdock a salary or wages for the work he performed on behalf of taxpayer. For 1995, 1996, and 1997, taxpayer issued to Murdock a Schedule K-1 (Shareholder's Share of Income, Credits, Deductions, etc.) for each year, showing that Murdock's share of taxpayer's ordinary income from business for those years was $29,671, $29,402 and $41,668, respectively. For the tax years 1995, 1996, and 1997, Murdock and his wife reported taxpayer's net income (as indicated on the Schedules K-1) on

their joint federal income tax returns (Form 1040) as nonpassive income from an S corporation. The Commissioner issued to taxpayer a Notice of Determination in which it was determined that Murdock was an employee of taxpayer for purposes of federal employment taxes, and (2) taxpayer was not entitled to "safe harbor" relief from these taxes under Section 530 of the Revenue Act of 1978.

Taxpayer has filed a brief in which it maintains that Murdock and his wife filed their 1995, 1996, and 1997 federal tax returns (Forms 1040 and Schedules) in a manner consistent with receiving and reporting income from the profits of (the Subchapter S) taxpayer, and that taxpayer was never the employer of Murdock during any part of 1995, 1996 or 1997, or at any other time in taxpayer's existence, based on the application of the common law employer-employee relationship tests of control. The brief advances a number of theories supporting its position. We need not, however, analyze these arguments so as to decide them, for the case is squarely controlled by our opinion in **Nu-Look Design, Inc. v. Comm'r of Internal Revenue**, No. 03-2754, filed January 26, 2004. The fact patterns of and the legal arguments advanced in the two cases are virtually identical. Indeed counsel are familiar with **Nu-Look** because the same counsel were involved.

Nu-Look rejected the arguments advanced by the taxpayer here. The decision of the Tax Court will therefore be affirmed.

TO THE CLERK: Kindly file the foregoing opinion.

/s/ Edward R. Becker

Circuit Judge

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 03-2755

SUPERIOR PROSIDE, INC.,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

On Appeal From the United States Tax Court
(No. 00-04804)
Tax Court Judge: Honorable Mary Ann Cohen

Submitted Pursuant to Third Circuit
LAR 34.1(a)(2002)
January 12, 2004

Before: ALITO, CHERTOFF and BECKER,
Circuit Judges.

JUDGMENT

This cause came on to be heard on the record from the United States Tax Court and was submitted pursuant to Third Circuit LAR 34.1(a) (2002) on January 12, 2004.

On consideration whereof, it is now here ORDERED AND ADJUDGED by this Court that the decision of the said Tax Court of March 10, 2003, be, and the same is hereby, affirmed. All in accordance with the opinion of this Court. Costs taxed against appellant.

ATTEST:

/s/ Marcia M. Waldron
Clerk

Dated: 28 January 2004

Certified as a true copy and issued in lieu
of a formal mandate on 4-6-04

Teste: /s/ Marcia M. Waldron
Clerk, U.S. Court of Appeals for the Third Circuit

T.C. Memo. 2003-50

UNITED STATES TAX COURT

SUPERIOR PROSIDE, INC., Petitioner v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 4804-00 Filed February 26, 2003.

Joseph H. O'Donnell, Jr., for petitioner.

Linda P. Azmon, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COHEN, Judge: The petition in this case was filed in response to a Notice of Determination Concerning Worker Classification Under Section 7436 (notice of determination) regarding petitioner's liabilities pursuant to the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) for 1995, 1996, and 1997. The issues for decision are: (1) Whether Thomas L. Murdock (Murdock) was an employee of petitioner for Federal employment tax purposes during 1995 through 1997 and, if so, (2) whether petitioner is entitled to relief under sec.tion 530 of the Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2885, as amended (sec. 530).

Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure. For convenience, FICA and FUTA taxes are collectively referred to as employment taxes.

FINDINGS OF FACT

Some of the facts have been stipulated, and the stipulated facts are incorporated in our findings by this reference.

Petitioner's Organization and Operations

Petitioner is an S corporation that was incorporated in Pennsylvania on or about September 21, 1987. At all relevant times, petitioner's principal place of business was located in Levittown, Pennsylvania.

Since its organization, petitioner has operated as a siding contractor and residential remodeling service. This activity was and is petitioner's only business and only source of income. Murdock has been the sole shareholder of petitioner from the time of its incorporation and throughout 1995, 1996, and 1997.

Murdock has at all times also served as petitioner's president. During 1995, 1996, and 1997, Murdock performed the following services for petitioner: (1) Solicited business on behalf of petitioner; (2) ordered petitioner's supplies; (3) entered into verbal and/or written agreements on behalf of petitioner; (4) oversaw the finances of petitioner; (5) collected moneys owed petitioner; (6) managed petitioner; (7) obtained clients for petitioner; (8) hired and fired independent contractors on behalf of petitioner; (9) maintained customer satisfaction; and (10) supervised all work done on behalf of petitioner. No other person performed any service on behalf of petitioner.

During 1995, 1996, and 1997, petitioner did not make regular payments to Murdock for his services. Rather, Murdock obtained funds from petitioner as his needs arose. There were no set intervals at which Murdock would take these moneys from petitioner. Petitioner neither classified any payment as a dividend nor distributed any dividends to shareholders from 1995 through 1997.

Petitioner's Tax Reporting

Petitioner timely filed Forms 1120S, U.S. Income Tax Return for an S Corporation, and

related schedules, for the 1987 through 1994 taxable years. On these returns, petitioner did not report treating Murdock, or any other individual, as an employee of petitioner.

Petitioner filed a Form 1120S for each of the years 1995, 1996, and 1997. Petitioner reported ordinary income from its trade or business of $29,671.48, $29,402.99, and $41,668.75 for 1995, 1996, and 1997, respectively. Petitioner claimed no deduction either for compensation of officers or for salaries and wages. Schedules K-1, Shareholder's Share of Income Credits, Deductions, etc., attached to the returns show $29,671.46 for 1995, $29,402.99 for 1996, and $41,668.75 for 1997 as the pro rata share of, and as property distribution other than a dividend to, Murdock. Petitioner's Forms 1120S were signed by Murdock as president and by Joseph M. Grey (Grey) as preparer.

During the period from 1995 to 1997, petitioner did not issue any Forms 1099-MISC, Miscellaneous Income, or Forms W-2, Wage and Tax Statement, to Murdock. Since petitioner's incorporation in 1987, petitioner has not reported paying Murdock a salary or wages for work he performed on behalf of petitioner.

Petitioner did not file a Form 941, Employer's Quarterly Federal Tax Return, for any quarters in 1995, 1996, and 1997 or a Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 1995, 1996, and 1997. Throughout this period, petitioner did not treat any individual as an employee.

Murdock's Tax Reporting

For each of the years 1995, 1996, and 1997, Murdock and his wife filed a joint Form 1040, U.S. Individual Income Tax Return. On these returns, Murdock reported as ordinary income from "Rental real estate, royalties, partnerships, S corporations, trusts, etc." $29,671.48,

$29,402.99, and $41,668.75 for 1995, 1996, and 1997, respectively. Attached Schedule E, Supplemental Income and Loss, characterize the foregoing amounts as nonpassive income from Schedules K-1.

The Notice of Determination

Prior to the audit underlying the instant case covering 1995, 1996, and 1997, respondent neither audited petitioner for employment tax purposes nor challenged petitioner's treatment of Murdock as other than an employee. Thereafter, on February 23, 2000, respondent sent to petitioner the notice of determination at issue in this proceeding. The notice was based on a determination that Murdock was to be legally classified as an employee for purposes of Federal employment taxes and that petitioner was not entitled to relief from such classification pursuant to sec. 530. Enclosed with the notice was a schedule setting forth petitioner's liabilities for FICA and FUTA taxes.

The parties have stipulated that, if the Court decides that Murdock is to be classified as an employee for Federal employment tax purposes for all periods in 1995, 1996, and 1997, the amounts of taxes due and owing are as set forth in the notice of determination. Conversely, if the Court decides that Murdock should not be classified as an employee for any of the periods in issue, the parties agree that petitioner owes no employment taxes.

ULTIMATE FINDINGS OF FACT

Murdock, as president of petitioner, performed more than minor services and received remuneration therefor.

Petitioner did not have a reasonable basis for failing to treat Murdock as an employee during the years in issue.

OPINION

I. Statutory and Regulatory Provisions

A. Subtitle C of the Internal Revenue Code

Subtitle C of the Internal Revenue Code governs payment of employment taxes. In particular, secs. 3111 and 3301 impose taxes on employers under FICA (pertaining to Social Security) and FUTA (pertaining to unemployment), respectively, based on wages paid to employees. The term "wages" as used in these statutes generally encompasses "all remuneration for employment". Secs. 3121(a), 3306(b). "Employee" is defined for purposes of FICA taxes in sec. 3121(d), and, with modifications not germane here, sec. 3306(i) makes this definition applicable for purposes of FUTA taxes as well. Sec. 3121(d)(1) provides:

> SEC. 3121(d). Employee.--For purposes of this chapter, the term "employee" means--
>
> (1) any officer of a corporation; or
>
> (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or
>
> (3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person--
>
> (A) as an agent-driver or commission-driver * * *;
>
> (B) as a full-time insurance salesman * * *;
>
> (C) as a home worker * * *; or
>
> (D) as a traveling or city salesman * * *;

* * * [under specified conditions]; or

(4) any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

Regulations promulgated under sec. 3121(d) clarify the scope of the inclusion in paragraph (1) for corporate officers, as follows:

Generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither received nor is entitled to receive, any remuneration is considered not to be an employee of the corporation. * * * [Sec. 31.3121(d)-1(b), Employment Tax Regs.].

Identical language is also included in regulations promulgated under sec. 3306. Sec. 31.3306(i)-1(e), Employment Tax Regs..

B. Section 530 of the Revenue Act of 1978

Sec. 530 operates in enumerated circumstances to afford relief from employment tax liability, notwithstanding the actual relationship between the taxpayer and the individual performing services. The statute provides, in part:

SEC. 530. CONTROVERSIES INVOLVING WHETHER INDIVIDUALS ARE EMPLOYEES FOR PURPOSES OF THE EMPLOYMENT TAXES.

(a) Termination of Certain Employment Tax Liability. --

(1) In general. --if --

(A) for purposes of employment taxes, the taxpayerdid not treat an individual as an employee for any period, and

(B) in the case of periods after December

31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

(2) Statutory standards providing one method of satisfying the requirements of paragraph (1).--For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

(A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

(B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

In specified circumstances, sec. 530(e)(4) places the burden of proof on the Commissioner with respect to certain issues under sec. 530, but this provision does not affect our analysis here. Sec. 530(e)(4) applies only to periods after December 31, 1996. Small Business Job Protection Act of 1996, Pub. L. 104-188, sec. 1122(b)(3), 110 Stat. 1767. For subsequent periods, a

taxpayer desiring to take advantage of sec. 530(e)(4) first must establish a prima facie case that it was reasonable not to treat an individual as an employee and must have fully cooperated with the Secretary. Because, as explained in detail below, petitioner did not establish a prima facie case that its treatment of Murdock was reasonable, the burden of proof remains on petitioner with respect to 1997 as well.

II. Classification of Murdock for Employment Tax Purposes

A. Status Under FICA and FUTA Provisions

In contending that Murdock should not be classified as an employee under the FICA and FUTA provisions of the Internal Revenue Code, petitioner focuses on Murdock's status as an S corporation shareholder and alleged lack of status as a common law employee. We briefly address these contentions seriatim.

1. Contentions Regarding S corporation Shareholders

Petitioner cites secs. 1366, 1372, and 6037(c) and **Durando v. United States**, 70 F.3d 548 (9th Cir. 1995), presumably in support of an argument that S corporation shareholders should not be deemed employees. Secs. 1366 and 6037(c) generally require that income items of S corporations be passed through to shareholders on a pro rata basis and reported by such shareholders in a manner consistent with treatment on the corporate return. These rules, however, pertain to calculation of income tax liabilit under subtitle A and have no bearing on computation of Federal employment taxes. **Veterinary Surgical Consultants, P.C. v. Commissioner**, 117 T.C. 141, 145 (2001), affd. sub nom. **Yeagle Drywall Co. v. Commissioner**, 54 Fed. Appx. 100 (3d Cir. 2002).

Furthermore, an employer cannot by the expedient of characterizing moneys paid in remuneration for services as distributions of net income, rather than as wages, avoid FICA and FUTA liabilities. **Id.** at 145-146. Thus, as in Veterinary Surgical Consultants, P.C., supra at 145-146, and **Joseph M. grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. 121, 128 (2002), we reject any suggestion that petitioner's passing through of its net income to Murdock precludes the finding of an employer-employee relationship between petitioner and Murdock. We likewise reject as not germane to the question before us of petitioner's reliance on sec. 1372, addressing fringe benefits under subtitle A, and the reference to that statute in **Durando v. United States, supra** at 551. See **Veterinary Surgical Consultants, P.C., supra** at 147-148, 150.

2. Contentions Regarding Common Law Employment

Petitioner contends that "employee" as used throughout sec. 3121(d) must be construed in a manner consistent with its use in sec. 3121(d)(2), such that the usual common law rules for determining existence of an employer-employee relationship are to be taken into account. In support of this position, petitioner quotes the following passage from **Tex. Carbonate Co. v. Phinney**, 307 F.2d 289, 291-292 (5th Cir. 1962):

> The statutory definition of "employees" as including officers of a corporation will not be so construed as to mean that an officer is an employee per se. Only such officers as work for it in fact are to be so included and, in determining whether an officer is an employee within the meaning of the statutes the usual employer-employee tests are to be applied. * * *

Petitioner further emphasizes that common law focuses on whether the alleged employer held the right to control the details of the work performed by the individual and argues that petitioner did not exercise control over Murdock during 1995, 1996, or 1997. There exist, however, at least two fatal defects in petitioner's arguments in this regard.

First, from the standpoint of statutory construction, the premise underlying petitioner's position finds no support either in the structure of the text or in the **Tex. Carbonate Co., supra**, decision. Sec. 3121(d) is written in the disjunctive, with each of the four paragraphs expressly separated from the next by "or". Accordingly, each paragraph affords a separate and independent basis for deeming one engaged to perform services an employee. Individuals described in paragraph (1), (3), and (4) of sec. 3121(d) are therefore frequently referred to as "statutory" employees, subject to FICA and FUTA regardless of their status under common law. See **Joseph M. Grey Pub. Accountant, P.C., supra** at 126.

Moerover, **Tex. Carbonate Co, supra**, is not authority to the contrary. Significant regulatory and statutory developments have occurred since the years in issue in that case. Given that secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs., were promulgated after those years and that the FUTA definition of "employee" then in effect appears to have contemplated a corporate officer who could be an independent contractor under common law, see, e.g., sec. 1607(i), I.R.C. 1939, the Courts of Appeals' statements concerning common law rules "may no longer be relevant." **Joseph M. Grey Pub. Accountant, P.C., supra** at 128 n.4. The opinion in **Tex. Carbonate Co., supra** at 291, recognized that, regardless of the test purportedly being applied,

"such officers as work for * * * [a corporation] in fact" are included as employees. The court also addressed the impact of an alleged absence of control in that case, as follows:

> Even though an absence of control is shown, and this as we have noted has not been done, the force of the factor is diminished to near de minimis by the fact that * * * [the service provider] himself was a member of the Board of Directors, a Vice President, and the executive of the Company in charge of its sales and the development of its markets. * * * [**Id.** at 292].

Hence, critical components of the analysis in **Tex. Carbonate Co, supra**, are consistent with the current regulatory approach to officers and contrary to petitioner's position.

Second, from a factual standpoint, even if the common law control factor were pertinent to our evaluation, petitioner has failed to establish a lack of control over Murdock in the performance of his services. As in **Joseph M. Grey Pub. Accountant, P.C., supra** at 128-129, to accept petitioner's contentions in this regard would be the equivalent of disregarding the corporate form in which Murdock chose to conduct his business. Caselaw does not permit a taxpayer to use his or her dual role as a shareholder of and service provider to a corporation as grounds for ignoring the legal ramifications of the business construct so selected. **Moline Props., Inc. v. Commissioner**, 319 U.S. 436, 438-439 (1943); **Joseph M. Grey Pub. Accountant, P.C., supra** at 129.

3. Application of Section 3121(d)(1)

On the basis of the foregoing analysis, application of sec. 3121(d)(1) is not precluded or limited here by considerations pertaining to

Murdock's status as an S corporation shareholder or under the common law. Sec. 3121(d)(1) and secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs., specify that corporate officers are to be classified as employees if they perform more than minor services and receive or are entitled to receive remuneration. The overwhelming weight of the evidence here shows that Murdock's activities vis-a-vis petitioner met these criteria. (Accordingly, considerations with respect to burden of proof do not affect our analysis on this point.) Murdock at all relevant times served as petitioner's president and worked for petitioner in all significant aspects of petitioner's business operations. As Murdock testified, no other person performed services for petitioner during 1995, 1996, or 1997. Murdock also obtained remuneration from petitioner as his needs arose.

Furthermore, although sec. 3121(d)(1) may be inapplicable to the extent that an officer performs services in some other capacity, i.e., as an independent contractor, petitioner has neither contended nor offered evidence that Murdock worked for or was engaged by petitioner in a capacity other than president. See **Joseph M. Grey Pub. Accountant, P.C., supra,** at 129-130; Rev. Rul. 82-83, 1982-1 C.B. 151, 152. Hence, we conclude that Murdock was an employee of petitioner for employment tax purposes, in accordance with sec. 3121(d)(1).

B. Availability of Section 530 Relief

Sec. 530 affords relief from employment tax liability, notwithstanding an adverse classification, where the following three requirements are satisfied: (1) the taxpayer has not treated the individual, or any individual holding a substantially similar position, as an employee for any period; (2) the taxpayer has consistently treated the individual as not being

an employee on all tax returns for periods after December 31, 1978; and (3) the taxpayer has a reasonable basis for not treating the individual as an employee. Sec. 530(a)(1), (3). With respect to the case at bar, respondent has conceded that petitioner meets the first of the above requirements and does not argue that petitioner fails to meet the second. Rather, the parties dispute whether petitioner has a reasonable basis for not treating Murdock as an employee.

Concerning the existence of a reasonable basis for purposes of sec. 530(a)(1), sec. 530(a)(2) sets forth three statutory safe havens. Reliance upon any of the circumstances enumerated in subparagraph (A), (B), or (C) of sec. 530(a)(2) is deemed sufficient to establish the requisite reasonable basis.

Subparagraph (A) lists judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer. The second amended petition alleges:

> For reasonable basis for Petitioner's reliance on the non-employee status of Thomas L, Murdock in reference to his services performed on behalf of Petitioner during 1995, 1996, and 1997, Petitioner asserts judicial precedent in **Texas Carbonate Company v. R.L. Phinney**, 307 F.2d 289 (5th Cir.), **cert. denied**, 371 U.S. 940 (1962); wherein that Court's opinion stated that an officer of a corporation is not an employee per se, and that an employer and employee (master and servant) relationship must exist between a corporation and an officer of the corporation, for which an officer performs services.

On brief, petitioner reiterates reliance on **Tex. Carbonate Co, supra**, and cites as well to **Automated Typesetting, Inc. v. United States**, 527 F. Supp. 515 (E.D. Wis. 1981), in

support of the premise that petitioner reasonably looked to common law control concepts in classifying Murdock.

For the reasons previously discussed, **Tex. Carbonate Co, supra,** does not afford a reasonable basis for disregard of the explicit rules of sec. 3121(d)(1) and secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs.. Equally unavailing in this regard is **Automated Typesetting, Inc., supra.** The District Court in that case simply evaluated the employment relationship of the involved individuals both through a common law analysis and through application of the provisions relating to corporate officers. **Id.** at 519-522. In deciding that the individuals qualified as employees under either rubric, the court did not repudiate the statutory treatment of corporate executives. **Id.** at 520, 522; see also **Joseph M. Grey Pub. Accountant, P.C., supra** at 129 n.5.

Moreover, even if we were to assume arguendo that the cited cases could offer a reasonable basis for treating an officer as a nonemployee, petitioner has failed to establish reliance on the claimed precedent as a factual matter. To fall within the safe harbors of sec. 530(a)(2), the petitioner must have relied on the alleged authority during the periods in issue, at the time the employment decisions were being made. The statute does not countenance ex post facto justification. See **303 W. 42nd St. Enters., Inc. v. IRS**, 181 F.3d 272, 277, 279 (2d Cir. 1999) (reversing and remanding because it was "unclear from the record whether * * * [the taxpayer] in fact relied on any specific industry practice in reaching its decision to treat its * * * [workers] as non-employee tenants, let alone whether such reliance was reasonable"); **Select Rehab, Inc. v. United States**, 205 F. Supp. 2d 376, 380 (M.D. Pa. 2002) ("The

taxpayer must show that it relied upon those grounds [alleged as a reasonable basis], and that the reliance was reasonable."); **W. Va. Pers. Servs., Inc. v. United States**, 78 AFTR 2d 96-6600, at 96-6608, 96-2 USTC par. 50,554, at 85,919 (S.D. W. Va. 1996) ("The plain meaning of section 530(a)(2) is that only evidence known to and relied upon by the taxpayer is relevant. Facts that are learned after the incorrect treatment of the employees * * * are not facts that a taxpayer relied upon in making its original decision regarding how to treat its employees.")

Until shortly before trial, petitioner did not purport to rely on sec. 530 or the bases described therein and expressly disclaimed any dependence on the statute. Petitioner's present claim of reliance is not credible. The following colloquy transpired at trial between Murdock and counsel for respondent:

> Q [Counsel for respondent] Mr. Murdock, are you familiar with a case, Texas Carbonate versus Phinney?
>
> A [Murdock] No, I'm not.
>
> Q No one ever discussed that case with you?
>
> A No.

Petitioner proposed to call Grey, the accountant who advised petitioner and prepared petitioner's tax returns. Grey was not allowed to testify in that case because he had not been listed as a witness in petitioner's trial memorandum, in violation of this Court's Standing Pre-Trial Order. See Rule 131(b). His testimony, in any event, would not have made a difference. See **Veterinary Surgical Consultants, P.C.**, T.C. Memo 2003-48 (where Grey testified that he was unaware of the **Tex. Carbonate Co., supra**, case until posttrial briefing, during the fall of 2001, in **Joseph M. Grey**

Pub. Accountant, P.C. v. Commissioner, 119 T.C. 121 (2002)). Petitioner failed to establish that it relied on judicial precedent or, for that matter, on any of the other sources specified in sec. 530(a)(2)(A). Accordingly, we conclude that subparagraph (A) does not aid petitioner here.

The same result obtains with respect to subparagraphs (B) and (C). The parties have stipulated that respondent did not audit petitioner for employment tax purposes prior to the examination underlying the present case. Petitioner therefore cannot show reliance on a past audit under sec. 530(a)(2)(B). Likewise, petitioner has adduced no evidence of conventions in the siding and remodeling industry to establish longstanding industry practice under sec. 530(a)(2)(C). The safe havens of sec. 530(a)(2) are therefore inapplicable on the record before us.

In seeking to establish a reasonable basis for Murdock's treatment apart from the safe havens, petitioner quotes the following definition of "employment status" in sec. 530(c)(2): "The term "employment status" means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an employee)." Petitioner appararently believes that the purported lack of common law control makes its treatment of Murdock reasonable within the meaning of sec. 530 and that the above definition supports this view.

Again, however, petitioner's approach is contrary to controlling statutes and to the facts of this case. As a matter of construction, sec. 530(c)(2) defines employment status for purposes of certain provisions of sec. 530 not germane here. It does not purport to override or interpret the definition of "employee" in sec.

3121(d) and related regulations. Hence, sec. 530(c)(2) does not render it rational for petitioner to have ignored the statutory mandate regarding corporate officers and to have taken a position that was not otherwise supported by authority. Petitioner also does not claim in actuality to have relied on sec. 530(c)(2) in deciding not to treat Murdock as an employee in 1995, 1996, or 1997. We conclude and have found as a fact that petitioner did not have a reasonable basis for failing to characterize Murdock as an employee. Consequently, relief from employment tax liability is not available to petitioner under sec. 530.

C. Conclusion

We hold that Murdock is an employee of petitioner pursuant to sec. 3121(d)(1) and that petitioner is not entitled to relief under sec. 530. Accordingly, petitioner is liable for FICA and FUTA taxes for the periods in issue as set forth in respondent's notice of determination and the parties' stipulations.

To reflect the foregoing,

Decision will be entered for respondent and in accordance with the parties' stipulations as to amounts.

UNITED STATES TAX COURT
Washington, D.C. 20217

SUPERIOR PROSIDE, INC., Petitioner	)	
v.	)	Docket No. 4804-00
COMMISSIONER OF INTERNAL REVENUE, Respondent	)	EMPLOYMENT

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion (T.C. Memo. 2003-50) filed February 26, 2003, it is hereby

ORDERED and DECIDED: That Thomas L. Murdock is classified as an employee of petitioner for purposes of Federal employment taxes under Subtitle C of the Internal Revenue Code with respect to the taxable quarters ended March 31, 1995; June 30, 1995; September 30, 1995; December 31, 1995; March 31, 1996; June 30, 1996; September 30, 1996; December 31, 1996; March 31, 1997; June 30, 1997; September 30, 1997; December 31, 1997.

That petitioner is not entitled to relief under Section 530 of the Revenue Act of 1978 with respect to Thomas L. Murdock.

That the proper amounts of employment tax under the above determination are as shown below:

Federal Insurance Contributions Act (FICA) Tax Imposed Under I.R.C. Secs. 3101, 3102(a), and 3111

Tax Period Ended	Amount of Tax
Mar. 31, 1995	$1,135
June 30, 1995	1,135
Sept. 30, 1995	1,135
Dec. 31, 1995	1,135
Mar. 31, 1996	1,125
June 30, 1996	1,125
Sept. 30, 1996	1,125
Dec. 31, 1996	1,125
Mar. 31, 1997	1,594
June 30, 1997	1,594
Sept. 30, 1997	1,594
Dec. 31, 1997	1,594

Federal Unemployment Tax Act (FUTA) Tax Imposed Under I.R.C. Sec. 3301

Tax Period Ended	Amount of Tax
Dec. 31, 1995	$ 434
Dec. 31. 1996	434
Dec. 31. 1997	434

/s/ Mary Ann Cohen
Judge

Entered: MAR 10 2003

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 03-2755

SUPERIOR PROSIDE, INC.,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

Present: SCIRICA, Chief Judge, SLOVITER, NYGAARD, ALITO, ROTH, McKEE, RENDELL, BARRY, AMBRO, FUENTES, SMITH, CHERTOFF, FISHER and BECKER,* Circuit Judges.

SUR PETITION FOR PANEL REHEARING WITH SUGGESTION FOR REHEARING EN BANC

The petition for rehearing filed by Appellant having been submitted to the judges who participated in the decision of this Court, and to all the other available circuit judges in active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court **en banc**, the petition for rehearing is DENIED.

BY THE COURT:

/s/ Edward R. Becker
Circuit Judge

DATED: March 29, 2004
RLS/cc: JO, RF, RSM

*As to panel rehearing only.

NOT PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 03-2732

SPECIALTY TRANSPORT & DELIVERY SERVICES, INC.,

Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE

On Appeal from the Decision of the
United States Tax Court
(No. 01-10261)
United States Tax Court Judge:
Honorable Mary Ann Cohen

Submitted Under Third Circuit LAR 34.1(a)
January 15, 2004

Before: SLOVITER, RENDELL and ALDISERT,
Circuit Judges.

(Filed: March 12, 2004)

OPINION OF THE COURT

ALDISERT, Circuit Judge.

This appeal from a decision of the United States Tax Court that decided that John Ludlow,

an officer and sole shareholder of the taxpayer, Specialty Transport & Delivery Services, Inc. ("Specialty Transport"), was an employee and that the taxpayer was therefore liable for taxes under the Federal Insurance Contributions Act ("FICA"), 26 U.S.C. Secs. 3101-3128, and the Federal Unemployment Tax Act ("FUTA"), 26 U.S.C. Secs. 3301-3311. We affirm for the rationale and holding set forth in **Nu-Look Design, Inc. v. Comm'r of Internal Revenue**, 356 F.3d 290 (3d Cir. 2004).

I.

Because counsel for the Appellant represented also the Appellants in **Nu-Look** as well the appeals resulting in non-precedential opinions in **Yeagle Drywall Co., Inc. v. Commissioner of Internal Revenue**, 54 Fed. Appx. 100 (3d Cir. 2002), and **Veterinary Surgical Consultants v. Commissioner of Internal Revenue**, No. 03-2733 (3d Cir. 2004), and because we write only for the parties, our discussion will be truncated. We have to decide whether John F. Ludlow was an employee of the petitioner for federal employment tax purposes during 1996 through 1998 and, if so, whether petitioner is entitled to relief under Section 530 of the Revenue Act of 1978, as amended.

Ludlow had been in the business of providing hauling services since 1973. He subsequently decided to incorporate his business as Specialty Transport Delivery Services, Inc. on March 9, 1989, and since that time it has been operated as an S corporation.

Since its organization, Specialty Transport has provided pick up and delivery services to distributors, wholesalers and manufacturers of steel, steel coil and steel related products. This activity was and is the taxpayer's only business. It is also the only source of income to Ludlow. Ludlow was elected President, Vice

President, Secretary and Treasurer of taxpayer. He is also its sole director. During 1996 to 1998, Ludlow ordered and purchased supplies, entered into verbal and/or written agreements, oversaw the finances, collected monies owed, managed the company, maintained customer satisfaction, performed all bookkeeping services - with assistance from his spouse, Sharon Ludlow, from time to time - and performed all pick up and delivery services for customers on behalf of taxpayer. No other person provided any services whatsoever to the taxpayer.

During the periods in issue, taxpayer received customer referrals from Pyle Transport Services, Inc..

II.

The Taxpayer received a notice from the Internal Revenue Service - "Notice of Determination concerning worker classification under Sec. 7436" - advising that the IRS had determined that Ludlow was to be classified as an employee for purposes of employment taxes for the relevant years. It also advised that taxpayer was not "entitled to relief from this classification pursuant to Section 530 of the Revenue Act of 1978."

Taxpayer filed a timely petition for re-determination with the United States Tax Court.

The taxpayer did not make regular payments to Ludlow for his services. It claimed no deduction either for compensation of officers or for salaries or wages in 1996 or 1997. For 1998, its return reflects a deduction of $15,000.00 for compensation of an officer. Schedule K-1, Shareholder's Share of Income, Credits, Deductions, etc., attached to returns shows $15,605.36 for 1996, $27,362.14 for 1997 and $38,486.89 for 1998 as a pro rata share of, and as a property distribution other than a dividend

to, Ludlow. During this period taxpayer did not issue any Forms W-2, Wage and Tax Statement, to Ludlow. It did not issue any Forms 1099 to Ludlow in 1996 or 1997; it did in 1998 for "nonemployee compensation" and for "rents" of $7,200.00 for use of Ludlow's residence as a business office for taxpayer. Ludlow and his wife filed a joint form 1040 reporting as ordinary income from "rental real estate, royalties, partnerships, S corporations, trusts, etc." in the amounts of $15,605.36, $27,362.14 and $45,686.89 for 1996, 1997, and 1998, respectively.

Based on these facts the Tax Court determined that the IRS had not erred in classifying Ludlow as an employee under FICA and FUTA. It found that the payments received by him were remuneration for substantial services performed on behalf of the taxpayer. The court also concluded that the taxpayer could not obtain relief from the taxes due under the safe harbor established by Section 530 of the Revenue Act of 1978.

III.

We have "exclusive jurisdiction," 26 U.S.C. Sec. 7482(a), "to review the decisions of the tax court...in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury[.]" 26 USC Sec. 7482(a)(1). Our review is plenary over findings determinations of law including a construction and application of the Internal Revenue Code. **PNC Bankcorp, Inc. v. Comm'r of Internal Revenue**, 212 F.3d 822, 827 (3d Cir. 2000).

IV.

FICA and FUTA impose taxes on employers based on the wages paid to individuals in their employ. 26 U.S.C. Secs. 3111, 3301. "Wages" is defined broadly by both Acts, with certain exceptions not applicable here, as "all

remuneration for employment[.]" **Id** Secs. 3121(a), 3306(b). Employment is defined as "any service of whatever nature, performed...by an employee for the person employing him[.]" **Id.** Secs. 3121(b) and 3306(c). FICA also defines "employee" in pertinent part as "1) any officer of a corporation; or 2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee[.]" **Id.** Sec. 3121(d). Treasury Regulation Secs. 31.2-1(d)-1(b) restates the general rule that an officer of a corporation is an employee of the corporation and specifies that there is an exception for an "officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration[.]" 26 C.F.R. Secs. 31.3121(d)-1(b).

The Tax Court determined that Ludlow performed substantial services for the taxpayer and that distributions of income received were remuneration for the services rendered. Accordingly, it held that the taxpayer was liable for future federal employment taxes under the FICA and FUTA.

V.

We are in complete agreement with the Tax Court. Ludlow's services were not minor. He performed all tasks for the taxpayer. These services were substantial because he was the only employee. Accordingly, the Tax Court did not err in concluding that the distribution of income paid by the taxpayer were remunerations for services rendered, thereby constituting wages under both FICA and the FUTA. See **Nu-Look Design, Inc.**, 356 F.3d at 294.

Taxpayer relies on the teachings of **Texas Carbonate Co. v. Phinney**, 307 F.2d 289 (5th

Cir. 1962). Suffice it to say, in **Bu-Look Design, Inc.**, we addressed the identical argument and rejected it, concluding "Nu-Look's reliance on **Texas Carbonate** is puzzling." 356 F.3d at 294.

VI.

Section 530 of the Revenue Act of 1978 is a safe harbor for taxpayers who owe FICA and FUTA taxes as the result of wrongfully failing to classify certain individuals as employees. This uncodified section relieves the taxpayer of certain federal employment tax liabilities arising from a failure to treat an individual as an employee if the taxpayer had a "reasonable basis for not treating such an individual as an employee." Section 530(a)(2). Appellant argues that it is entitled to relief under this section. In **Nu-Look Design, Inc.**, we rejected this argument as well 356 F.3d at 294.

Taxpayer's main contention is that it reasonably relied on the usual common law rules for determining an employer-employee relationship and not classifying Ludlow as an employee. We were not persuaded by this argument in **Nu-Look Design, Inc.**, 356 F.3d at 293-294.

VII.

Taxpayer alleges a due process violation because the IRS failed to give written notice of Section 530 at the commencement of the audit inquiry. The Tax Court rejected this argument, explaining that relief under the due process clause required some showing of prejudice. We repeat what we said in **Nu-Look Design, Inc.**, that because the record is devoid of evidence of any actual prejudice, it may not prevail. 356 F.3d at 295.

We will affirm the decision of the Tax Court.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 03-2732

SPECIALTY TRANSPORT & DELIVERY SERVICES, INC.,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

On Appeal from the Decision of the
United States Tax Court
(No. 01-10261)
United States Tax Court Judge:
Honorable Mary Ann Cohen

Submitted Under Third Circuit LAR 34.1(a)
January 15, 2004

Before: SLOVITER, RENDELL and ALDISERT,
Circuit Judges.

JUDGMENT

This cause came on to be considered on the record from the United States Tax Court and was submitted pursuant to Third Circuit LAR 34.1(a) on January 15, 2004.

On consideration whereof, it is now hereby ADJUDGED and ORDERED that the decision of the United States Tax Court filed February 26, 2003, be and the same is hereby affirmed. All of the

above in accordance with the opinion of this Court.

Costs taxed against Appellant.

ATTEST:

/s/ Marcia M. Waldron
Clerk

Dated: 12 March 2004

Costs taxed in favor of Appellee as follows:

Brief & Sup. Apx...$57.60

TOTAL.....$57.60

Certified as a true copy and issued in lieu of a formal mandate on May 13, 2004

Teste: /s/ Marcia M. Waldron
Clerk, U.S. Court of Appeals for the Third Circuit

T.C. Memo. 2003-51

UNITED STATES TAX COURT

SPECIALTY TRANSPORT & DELIVERY SERVICES, INC.,
Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 10261-01 Filed February 26, 2003.

Joseph H. O'Donnell, Jr, for petitioner.

Pamela J. Arthur-Gerlach, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

COHEN, **Judge**: The petition in this case was filed in response to a Notice of Determination Concerning Worker Classification Under Section 7436 (notice of determination) regarding petitioner's liabilities pursuant to the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) for 1996, 1997, and 1998. The issues for decision are: (1) Whether John F. Ludlow (Ludlow) was an employee of petitioner for Federal employment tax purposes during 1996 through 1998 and, if so, (2) whether petitioner is entitled to relief under section 530 of the Revenue Act of 1978, Pub. L. 95-600, 92 Stat. 2885, as amended (sec. 530).

Unless otherwise indicated, all section references are to the Internal Revenue Code in effect for the years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure. For convenience, FICA and FUTA taxes are collectively referred to as employment taxes.

FINDINGS OF FACT

Some of the facts were deemed stipulated pursuant to Rule 91(f); certain additional facts

have been stipulated by the parties. The stipulated facts are incorporated in our findings by this reference.

Petitioner's Organization and Operations

Ludlow has been in the business of providing hauling services since 1973. He subsequently decided to incorporate his business on account of the protections afforded by limited liability, in that a corporation's debts are generally not assessed against individual shareholders, since the trucking business involves a high degree of potential liability in the event of an accident. Petitioner was incorporated in Pennsylvania on March 9, 1989, and has at all relevant times operated as an S corporation. Petitioner's principal place of business has been located in Levittown, Pennsylvania, at the address of Ludlow's personal residence, from the time of its incorporation to the present.

Since its organization, petitioner has provided pickup and delivery services to distributors, wholesalers, and manufacturers of steel, steel coil, and steel-related products. This activity was and is petitioner's only business and only source of income. Ludlow has been the sole shareholder of petitioner from the time of its incorporation and throughout 1996, 1997, and 1998.

Ludlow has at all times served as petitioner's president and only officer. Minutes from petitioner's annual meetings of directors and shareholders reflect that, for each of the years in issue, Ludlow was elected president, vice president, secretary, and treasurer. Ludlow was also petitioner's sole director. During 1996, 1997, and 1998, Ludlow performed the following services for petitioner: (1) Ordered and purchased supplies on behalf of petitioner; (2) entered into verbal and/or written agreements on behalf of petitioner; (3) oversaw the finances of

petitioner; (4) collected moneys owed petitioner; (5) managed petitioner; (6) maintained customer satisfaction; (7) performed all bookkeeping services for petitioner, with assistance from his spouse, Sharon Ludlow, from time to time; and (8) performed all pickup and delivery services for clients on behalf of petitioner. No other person provided any services to petitioner.

During the period in issue, petitioner received client referrals from Pyle Transport Services, Inc. (Pyle Transport), of West Chester, Pennsylvania. Ludlow performed services on behalfof petitioner pursuant to an "Independent Contractor Service Agreement" between petitioner and Pyle Transport, dated March 25, 1993, and identifying Ludlow as the driver for petitioner.

During 1996, 1997, and 1998, petitioner maintained a business/commercial checking account. Ludlow shared signature authority on petitioner's account with his spouse. Petitioner did not make regular payments at fixed times to Ludlow for his services. Rather, Ludlow, or his wife, obtained funds from petitioner's bank account to pay Ludlow as his needs arose. Petitioner neither classified any payment as a dividend nor distributed any dividends to shareholders from 1996 through 1998.

Petitioner's Tax Reporting

Petitioner timely filed Forms 1120S, U.S. Income Tax Return for an S Corporation, and related schedules, for 1989 through 1995. On these returns, petitioner did not report treating Ludlow, or any other individual, as an employee of petitioner.

Petitioner filed a Form 1120S for each of the years 1996, 1997, and 1998. Petitioner reported ordinary income from its trade or business of $15,605.36, $27,362.14, and $38,486.89 for 1996, 1997, and 1998, respectively. Petitioner claimed no deduction

either for compensation of officers or salaries and wages in 1996, 1997; for 1998, petitioner's return reflects a deduction of $15,000 for compensation of officers. Schedule K-1, Shareholder's Share of Income, Credits, Deductions, etc., attached to the returns show $15,605.36 for 1996, $27,362.14 for 1997, and $38,486.89 for 1998 as the pro rata share of, and as a property distribution other than a dividend to, Ludlow. Petitioner's Forms 1120S were signed by Ludlow as president and by Joseph M. Grey (Grey) as preparer.

During the period from 1996 to 1998, petitioner did not issue any Forms W-2, Wage and Tax Statement, to Ludlow. Petitioner did not issue any Forms 1099-MISC, Miscellaneous Income, to Ludlow in 1996 or 1997. In 1998, petitioner issued a Form 1099-MISC to Ludlow for $15,000 "non-employee Compensation" and $7,200 "rents" for the use of Ludlow's residence as a business office for petitioner. Since petitioner's incorporation in 1989, petitioner has not reported paying Ludlow a salary or wages for work he performed on behalf of petitioner.

Petitioner did not file a Form 941, Employer's Quarterly Federal Tax Return, for any quarter in 1996, 1997, or 1998 or a Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, for 1996, 1997, or 1998.

The Ludlows' Tax Reporting

For each of the years 1996, 1997, and 1998, Ludlow and his spouse filed a joint Form 1040, U.S. Individual Income Tax Return. On these returns, the Ludlows reported as ordinary income from "Rental real estate, royalties, partnerships, S corporations, trusts, etc." $15,605.36, $27,362.14, and $45,686.89 for 1996, 1997, and 1998, respectively. For 1996 and 1997, attached Schedules E, Supplemental Income and Loss, characterize the foregoing amounts as nonpassive

income from Schedules K-1. For 1998, $38,486.89 is shown on Schedule E as nonpassive income from Schedules K-1; $7,200 is shown on Schedule E and on Form 4831, Rental Income, as rent; and $15,000 is shown on Schedule C, Profit or Loss From Business, as gross receipts. (Although a deemed stipulation states that $45,686.89 was reported on the 1998 Schedule E as nonpassive income from Schedules K-1, a subsequent stipulation and documentary evidence reveal the allocation above.)

The Notice of Determination

Prior to the audit underlying the instant case covering 1996, 1997, and 1998, respondent neither audited petitioner for employment tax purposes nor challenged petitioner's treatment of Ludlow as other than an employee. Thereafter, on June 8, 2001, respondent sent to petitioner the notice of determination at issue in this proceeding. The notice was based on a determination that Ludlow was to be legally classified as an employee for purposes of Federal employment taxes and that petitioner was not entitled to relief from such classification pursuant to Sec. 530. Enclosed with the notice was a schedule setting forth petitioner's liabilities for FICA and FUTA taxes.

It is stipulated that, if the Court decides that Ludlow is to be classified as an employee for Federal employment tax purposes for all periods in 1996, 1997, and 1998, the amounts of taxes due and owing are as set forth in the notice of determination. Conversely, if the Court decides that Ludlow should not be classified as an employee for any of the periods in issue, the parties agree that petitioner owes no employment taxes.

ULTIMATE FINDINGS OF FACT

Ludlow, as president of petitioner, performed

more than minor services and received remuneration therefor.

Petitioner did not have a reasonable basis for failing to treat Ludlow as an employee during the years in issue.

OPINION

I. Statutory and Regulatory Provisions

A. Subtitle C of the Internal Revenue Code

Subtitle C of the Internal Revenue Code governs payment of employment taxes. In particular, secs. 3111 and 3301 impose taxes on employees under FICA (pertaining to Social Security) and FUTA (pertaining to unemployment), respectively, based on wages paid to employees. The term "wages" as used in these statutes generally encompasses "all remuneration for employment". Secs. 3121(a), 3306(b). "Employee" is defined for purposes of FICA taxes in sec. 3121(d), and, with modifications not german here, sec. 3306(i) makes this definition applicable for purposes of FUTA taxes as well. Sec. 3121(d) provides:

> SEC. #!@!(d). Employee.--For purposes of this chapter, the term "employee" means--
>
> (1) any officer of a corporation; or
>
> (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or
>
> (3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person--
>
> (A) as an agent-driver or commission-driver * * *;
>
> (B) as a full-time insurance salesman;

(C) as a home worker * * *; or

(D) as a traveling or city saleman * * *;

* * * [under specified conditions]; or

(4) any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

Regulations promulgated under section 3121(d) clarify the scope of the inclusion in paragraph (1) for corporate officers, as follows:

> Generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly, any remuneration is considered not to be an employee of the corporation. * * * [Sec. 31.3121(d)-1(b), Employment Tax Regs.].

Identical language is also included in regulations promulgated under sec. 3306. Sec. 31.3306(i)-1(e), Employment Tax Regs..

B. Section 530 of the Revenue Act of 1978

Sec. 530 operates in enumerated circumstances to afford relief from employment tax liability, notwithstanding the actual relationship between the taxpayer and the individual performing services. The statute provides, in part:

> SEC. 530. CONTROVERSIES INVOLVING WHETHER INDIVIDUALS ARE EMPLOYEES FOR PURPOSES OF THE EMPLOYMENT TAXES.
>
> (a) Termination of Certain Employment Tax Liability.--
>
> (1) In general. --if--

(A) for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and

(B) in the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

(2) Statutory standards providing one method of satisfying the requirements of paragraph (1).--For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

(A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

(B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

In specified circumstances, sec. 530(e)(4)

places the burden of proof on the Commissioner with respect to certain issues under sec. 530, but this provision does not affect our analysis here. Sec. 530(e)(4) applies only to periods after December 31, 1996, so has no bearing on petitioner's liabilities for 1996. Small Business Job Protection Act of 1996, Pub. L. 104-188, sec. 1122(b)(3), 110 Stat. 1767. For subsequent periods, a taxpayer desiring to take advantage of sec. 530(e)(4) first must establish a prima facie case that it was reasonable not to treat an individual as an employee and must have fully cooperated with the Secretary. Because, as explained in detail below, petitioner did not establish a prima facie case that its treatment of Ludlow was reasonable, the burden of proof remains on petitioner with respect to 1997 and 1998 as well.

II. Classification of Ludlow for Employment Tax Purposes

A. Status Under FICA and FUTA Provisions

In contending that Ludlow should not be classified as an employee under FICA and FUTA provisions of the Internal Revenue Code, petitioner focuses on Ludlow's status as an S corporation shareholder and alleged lack of status as a common law employee. We briefly address these contentions seriatim.

1. Contentions Regarding S Corporation Shareholders

Petitioner cites secs. 1366, 1372, and 6037(c) and **Durando v. United States**, 70 F.3d 548 (9th Cir. 1995), presumably in support of an argument that S corporation shareholders should not be deemed employees. Secs. 1366 and 6037(c) generally require that income items of S corporations be passed through to shareholders on a pro rata basis and reported by such shareholders

in a manner consistent with treatment on the corporate return. These rules, however, pertain to calculation of income tax liability under subtitle A and have no bearing on computation of Federal employment taxes. **Veterinary Surgical Consultants, P.C. v. Commissioner**, 117 T.C. 141, 145 (2001), affd. sub nom. **Yeagle Drywall Co. v. Commissioner**, 54 Fed. Appx. 100 (3d Cir. 2002). Furthermore, an employer cannot by the expedient of characterizing moneys paid in remuneration for services as distributions of net income, rather than as wages, avoid FICA and FUTA liabilities. **Id.** at 145-146. Thus, as in **Veterinary Surgical Consultants, P.C., supra** at 145-146, and **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. 121, 128 (2002), we reject any suggestion that petitioner's passing through of its net income to Ludlow precludes the finding of an employer-employee relationship between petitioner and Ludlow. We likewise reject as not germane to the question before us petitioner's reliance on sec. 1372, addressing fringe benefits under subtitle A, and the reference to that statute in **Durando v. United States, supra** at 551. See **Veterinary Surgical Consultants, P.C., supra** at 147-148, 150.

2. Contentions Regarding Common Law Employment

Petitioner contends that "employee" as used throughout sec. 3121(d) must be construed in a manner consistent with its use in sec. 3121(d)(2), such that the usual common law rules for determining existence of an employer-employee relationship are to be taken into account. In support of this position, petitioner quotes the following passage from **Tex. Carbonate Co. v. Phinney**, 307 F.2d 289, 291-292 (5th Cir. 1962):

The statutory definition of "employees" as

> including officers of a corporation will not be so construed as to mean that an officer is an employee per se. Only such officers as work for it in fact are to be so included and, in determining whether an officer is an employee within the meaning of the statutes the usual employer-employee tests are to be applied. * * *

Petitioner further emphasizes that common law focuses on whether the alleged employer held the right to control the details of the work performed by the individual and argues that petitioner had neither the authority nor the ability to exert control over Ludlow. There exist, however, at least two fatal defects in petitioner's arguments in this regard.

First, from the standpoint of statutory construction, the premise underlying petitioner's position finds no support either in the structure of the text or in the **Tex. Carbonate Co., supra,** decision. Sec. 3121(d) is written in the disjunctive, with each of the four paragraphs expressly separated from the next by "or". Accordingly, each paragraph affords a separate and independent basis for deeming one engaged to perform services an employee. Individuals described in paragraph (1), (3), and (4) of sec. 3121(d) are therefore frequently referred to as "statutory" employees, subject to FICA and FUTA regardless of their status under common law. See **Joseph M. Grey Pub. Accountant, P.C., supra** at 126.

Moreover, **Tex. Carbonate Co., supra,** is not authority to the contrary. Significant regulatory and statutory developments have occurred since the years in issue in that case. Given that secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs., were promulgated after those years and that the FUTA definition of "employee" then in effect appears to have contemplated a corporate officer

who could be an independent contractor under common law, see, e.g., sec. 1607(i), I.R.C. 1939, the Court of appeals' statements concerning common law rules "may no longer be relevant." **Joseph M. Grey Pub. Accountant, P.C., supra** at 128 n.4. The opinion in **Tex. Carbonate Co., supra** at 291, recognized that, regardless of the test purportedly being applied, "such officers as work for * * *[a corporation] in fact" are included as employees. The court also addressed the impact of an alleged absence of control in that case, as follows:

> Even though an absence of control is shown, and this as we have noted has not been done, the force of the factor is diminished to near de minimis by the fact that * * * [the service provider] himself was a member of the Board of Directors, a Vice President, and the executive of the Company in charge of its sales and the development of its markets. * * * [**Id.** at 292].

Hence critical components of the analysis in **Tex. Carbonate, supra,** are consistent with the current regulatory approach to officers and contrary to petitioner's position.

Second, from a factual standpoint, even if the common law control factor were pertinent to our evaluation, petitioner has failed to establish a lack of control over Ludlow in the performance of his services. As in **Joseph M. Grey Pub. Accountant, P.C., supra,** at 128-129, to accept petitioner's contentions in this regard would be the equivalent of disregarding the corporate form in which Ludlow chose to conduct his business. Caselaw does not permit a taxpayer to use his or her dual role as a shareholder of and service provider to a corporation as grounds for ignoring the legal ramifications of the business construct so selected. **Moline Props., Inc. v. Commissioner,** 319 U.S. 416, 438-439 (1943); **Joseph M. Grey Pub. Accountant,**

P.C., supra at 129.

3. Application of Section 3121(d)(1)

On the basis of the foregoing analysis, application of sec. 3121(d)(1) is not precluded or limited here by considerations pertaining to Ludlow's status as an S corporation shareholder or under the common law. Sec. 3121(d)(1) and secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs., specify that corporate officers are to be classified as employees if they perform more than minor services and receive or are entitled to receive remuneration. The overwhelming weight of the evidence here shows that Ludlow's activities vis-a-vis petitioner met these criteria. (Accordingly, considerations with respect to burden of proof do not affect our analysis on this point.) Ludlow at all relevant times served as petitioner's president and worked in all aspects of petitioner's delivery operations. Ludlow also obtained remuneration from petitioner's bank account as his needs arose.

Furthermore, although sec. 3121(d)(1) may be inapplicable to the extent that an officer performs services in some other capacity, i.e., as an independent contractor, petitioner has offered no convincing evidence that Ludlow worked for or was engaged by petitioner in a capacity other than as an officer. See **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. at 129-130; Rev. Rul. 82-83, 1982-1 C.B. 151, 152. The only item referenced in the record that could suggest an independent contractor relationship is the Form 1099-MISC reporting nonemployee compensation for 1998. This document is uncorroborated by other evidence, such as a service agreement, and is entitled to little weight. See **Joseph M. Grey Pub. Accountant, P.C., supra** at 130. Hence, we conclude that Ludlow was an employee of petitioner for employment tax purposes, in accordance with sec. 3121(d)(1).

B. Availability of Section 530 Relief

Sec. 530 affords relief from employment tax liability, notwithstanding an adverse classification, where the following three requirements are satisfied: (1) The taxpayer has not treated the individual, or any individual holding a substantially similar position, as an employee for any period; (2) the taxpayer has consistently treated the individual as not being an employee on all tax returns for periods after December 31, 1978; and (3) the taxpayer has a reasonable basis for not treating the individual as an employee. Sec. 530(a)(1), (3). With respect to the case at bar, respondent has conceded that petitioner meets the first of the above requirements. As regards the second, respondent contends that petitioner did not meet this reporting requirement for 1996 and 1997, but, because of the Form 1099-MISC, respondent does not argue that a similar failure exists for 1998. The third requirement is in dispute for each 1996 through 1998, and since lack of a reasonable basis for not treating Ludlow as an employee will render sec. 530 relief unavailable for all years, without regard to the other criteria, we begin with this element.

Concerning the existence of a reasonable basis for purposes of sec. 530(a)(1), sec. 530(a)(2) sets forth three statutory safe havens. Reliance upon any of the circumstances enumerated in subparagraph (A), (B), or (C) of sec. 530(a)(2) is deemed sufficient to establish that requisite reasonable basis.

Subparagraph (A) lists judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer. The amended petition alleges:

> The Petitioner relies on judicial precedent as its reasonable basis for not treating John F. Ludlow, its sole shareholder

and president, as an employee during any part of 1996, 1997, and 1998; said judicial precedent is **Texas Carbonate Company v. R.L. Phinney,** 307 F.2d 289 (5th Cir.), **cert. denied,** 371 U.S. 940 (1962).

On brief, petitioner reiterates reliance on **Tex. Carbonate Co., supra,** and cites as well to **Automated Typesetting, Inc. v. United States,** 527 F. Supp. 515 (E.D. Wis. 1981) in support of the premise that petitioner reasonably looked to common law control concepts in classifying Ludlow.

For the reasons previously discussed, **Tex. Carbonate Co., supra,** does not afford a reasonable basis for disregard of the explicit rules of sec. 3121(d)(1) and secs. 31.3121(d)-1(b) and 31.3306(i)-1(e), Employment Tax Regs.. Equally unavailing in this regard is **Automated Typesetting, Inc., supra.** The District Court in that case simply evaluated the employment relationship of the involved individuals both through a common law analysis and through application of the provisions relating to corporate officers. **Id.** at 519-522. In deciding that the individuals qualified as employees under either rubric, the court did not repudiate the statutory treatment of corporate executives. **Id.** at 520, 522; see also **Joseph M. Grey Pub. Accountant, P.C., supra** at 129 n.5.

Moreover, even if we were to assume arguendo that the cited cases could offer a reasonable basis for treating an officer as a nonemployee, petitioner has failed to establish reliance on the claimed precedent as a factual matter. To fall within the safe harbors of sec. 530(a)(2), the taxpayer must have relied on the alleged authority during the periods in issue, at the time the employment decisions were being made. The statute does not contemplate ex post facto justification. See **303 W. 42nd St. Enters., Inc. v. IRS,** 181 F.3d 272, 277, 279 (2d Cir. 1999) (reversing

and remanding because it was "unclear from the record whether * * * [the taxpayer] in fact relied on any specific industry practice in reaching its decision to treat its * * * [workers] as non-employee tenants, let alone whether such reliance was reasonable"); **Select Rehab, Inc. v. United States**, 205 F. Supp. 2d 376, 380 (M.D. Pa. 2002) ("The taxpayer must show that it relied upon those grounds [alleged as a reasonable basis], and that the reliance was reasonable."); **W. Va. Pers. Servs., Inc. v. United States**, 78 AFTR 2d 96-6600, at 96-6608, 96-2 USTC par. 50,554, at 85,919 (S.D. W. Va. 1996) ("The plain meaning of section 530(a)(2) is that only evidence known to and relied upon by the taxpayer is relevant. Facts that are learned after the incorrect treatment of the employees * * * are not facts that a taxpayer relied upon in making its original decision regarding how to treat its employees.")

Until a few months before trial, petitioner did not purport to rely on sec. 530 or the bases described therein and expressly disclaimed any dependence on the statute. Petitioner's present claim of reliance is not credible. The following colloquy transpired at trial between Ludlow and counsel for respondent:

> Q [Counsel for respondent] Are you familiar with the case Texas Carbonate versus Phinney?
>
> A [Ludlow] No.
>
> Q Have you ever discussed that case with anyone?
>
> A No.

Petitioner proposed to call Grey, the accountant who advised petitioner and prepared petitioner's tax returns. Grey was not allowed to testify in this case because he had not been listed as a witness in petitioner's trial memorandum, in violation of this Court's Standing

Pre-Trial Order. See Rule 131(b). His testimony, in any event, would not have made a difference. See **Veterinary Surgical Consultants, P.C. v. Commissioner**, T.C. Memo 2003-48 (where Grey testified that he was unaware of the **Tex. Carbonate Co., supra**, case until posttrial briefing, during the fall of 2001, in **Joseph M. Grey Pub. Accountant, P.C. v. Commissioner**, 119 T.C. 121 (2002)). Petitioner failed to establish that it relied on judicial precedent or, for that matter, on any of the other sources specified in sec. 530(a)(2)(A). Accordingly, we conclude that subparagraph (A) does not aid petitioner here.

The same result obtains with respect to subparagraphs (B) and (C). The parties have stipulated that respondent did not audit petitioner for employment tax purposes prior to the examination underlying the present case. Petitioner therefore cannot show reliance on a past audit under sec. 530(a)(2)(B). Likewise, petitioner has adduced no evidence of conventions in the hauling industry to establish longstanding industry practice under sec. 530(a)(2)(C). The safe havens of sec. 530(a)(2) are therefore inapplicable on the record before us.

In seeking to establish a reasonable basis foe Ludlow treatment apart from the safe havens, petitioner quotes from the following definition of "employment status" in sec. 530(c)(2): "The term "employement status" means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an employee)." Petitioner apparently believes that the purported lack of common law control makes its treatment of Ludlow reasonable within the meaning of sec. 530 and that the above definition supports this view.

Again, however, petitioner's approach is

contrary to controlling statutes and to the facts of this case. As a matter of construction, sec. 530(c)(2) defines employment status for purposes of certain provisions of sec. 530 not germane here. It does not purport to override or interpret the definition of "employee" in sec. 3121(d) and related regulations. Hence, sec. 530(c)(2) does not render it rational for petitioner to have ignored the statutory mandate regarding corporate officers and to have taken a position that was not otherwise supported by authority. Petitioner also does not claim in actuality to have relied on sec. 530(c)(2) in deciding not to treat Ludlow as an employee in 1996, 1997, or 1998. We conclude and have found as a fact that petitioner did not have a reasonable basis for failing to characterize Ludlow as an employee. Consequently, relief from employment tax liability is not available to petitioner under sec. 530

Lastly, in connection with sec. 530, petitioner raises a due process argument. This issue has never been properly pled by petitioner. Rather, petitioner mentioned due process in its motion for leave to file an amended petition, did not allege a due process violation in the amended petition itself, and argued the matter only on brief. Generally, issues not properly raised prior to briefing will not be considered when to do so would prevent the opposing party from presenting evidence that might have been offered if the issue had been timely raised. **DiLeo v. Commissioner**, 96 T.C. 858, 891 (1991), affd. 959 F.2d 16 (2d Cir. 1992); **Shelby U.S. Distribs., Inc. v. Commissioner**, 71 T.C. 874, 885 (1979). Here, however, even if we were to treat the due process issue as appropriately before us, petitioner's position is without merit.

Sec. 530(e)(1) provides that the Internal Revenue Service "shall, before or at the commencement of any audit inquiry relating to the

employment status of one or more individuals who perform services for the taxpayer, provide the taxpayer with a written notice of the provisions of this section." Small Business Job Protection Act of 1996 sec. 1122(a), 110 Stat. 1766. On brief, petitioner alleges that it learned of the existence of sec. 530 only through the June 8, 2001, notice of determination which postdated by a substantial margin the commencement on July 2, 1999, of the underlying employment tax audit. Petitioner then states:

> The inaction of Respondent in not providing Petitioner with the required Sect. 530(e)(1) notice constitutes a serious Constitutional violation of Petitioner's right to due process, and Petitioner moves this Court to allow it to recover its legal fees, since the conduct of Respondent is so egregious against the Petitioner.

To the extent that petitioner's due process contentions take the form of a claim for litigation or administrative costs and fees under sec. 7430, such claim is premature. Rule 231(a)(2), as pertinent here, specifies that the appropriate time to seek recovery of legal costs follows service of a written opinion. See **McWilliams v. Commissioner**, 104 T.C. 320, 327 (1995); **Groetzinger v. Commissioner**, 87 T.C. 533, 548 (1986).

Furthermore, even if petitioner's allegations might be read as a plea encompassing other remedies, petitioner has failed to show that its situation satisfies the prerequisites for relief under the due process clause. As this Court has noted, even in a criminal context defendants are generally required to establish actual prejudice in order to obtain due process relief. **Riland v. Commissioner**, 79 T.C. 185, 197-198 (1982) (involving a claimed denial of due process on account of delay in issuance of the subject

deficiency notice). The record in the instant case is devoid of evidence of such prejudice. Although petitioner was made aware of sec. 530 at least prior to filing its petition with the Court, petitioner failed therein to raise the statute. Nonetheless, petitioner was subsequently granted leave to file an amended petition specifically to place at issue its right to relief under sec. 530. The matter (of substantive relief under sec. 530(a), not, as previously noted, of a due process violation based on sec. 530(e)(1) notice procedures) therefore was properly before the Court at trial, and petitioner was afforded an opportunity to be heard. Accordingly, no actual prejudice was sustained.

The above analysis is consistent with our recent jurisprudence on the notice provision contained in sec.3463(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, 112 Stat. 767. In **Smith v. Commissioner,** 114 T.C. 489 (2000), affd. 275 F.3d 912 (10th Cir. 2001), we considered this requirement that the Commissioner include on each notice of deficiency the last date for filing a petition with the Tax Court. We held that, where the Commissioner failed to place such date on the notice, but the taxpayers nonetheless received the notice and filed a petition in a timely manner, the notice was valid. **Id.** at 492. In so holding, we noted the absence of any delay prejudicial to the taxpayers' ability to petition the Court. **Id.** at 491-492.

Thus, failure to comply with certain procedural notice requirements does not rise to the level of a denial of due process where, as here, the taxpayer's opportunity to present its position is not prjudiced.

C. Conclusion

We hold that Ludlow is an employee of petitioner pursuant to sec. 3121(d)(1) and that

petitioner is not entitled to relief under sec. 530. Accordingly, petitioner is liable for FICA and FUTA taxes for the periods in issue as set forth in respondent's notice of determination and relevant stipulations.

To reflect the foregoing,

Decision will be entered for respondent and in accordance with stipulations as to amounts.

157a-F

UNITED STATES TAX COURT
Washington, D.C. 20217

SPECIALTY TRANSPORT & DELIVERY SERVICES, INC.,	)	
Petitioner	)	Docket No. 10261-01
	)	EMPLOYMENT
v.	)	
	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion (T.C. Memo. 2003-51) filed February 26, 2003, it is hereby

ORDERED and DECIDED: That John F. Ludlow is classified as an employee of petitioner for purposes of Federal employment taxes under Subtitle C of the Internal Revenue Code with respect to the taxable quarters ended March 31, 1996; June 30, 1996; September 30, 1996; December 31, 1996; March 31, 1997; June 30, 1997; September 30, 1997; December 31, 1997; March 31, 1998; June 30, 1998; September 30, 1998; and December 31, 1998.

That petitioner is not entitled to relief under the Section 530 of the Revenue Act of 1978 with respect to John F. Ludlow.

That the proper amounts of employment tax under the above determination are as shown below:

Federal Insurance Contributions Act (FICA) Tax Imposed Under I.R.C. Secs. 3101, 3102(a), and 3111 and Income Tax Withholding Under I.R.C. Secs. 3402 and 3403

Tax Period Ended	Amount of Tax
Mar. 31, 1996	$ 597
June 30, 1996	597
Sept. 30, 1996	597
Dec. 31, 1996	597
Mar. 31, 1997	1,047
June 30, 1997	1,047
Sept. 30, 1997	1,047
Dec. 31, 1997	1,047
Mar. 31, 1998	1,873
June 30, 1998	1,873
Sept. 30, 1998	1,873
Dec. 31, 1998	1,873

Federal Unemployment Tax Act (FUTA) Tax Imposed Under I.R.C. Sec. 3301

Tax Period Ended	Amount of Tax
Dec. 31, 1996	434
Dec. 31, 1997	434
Dec. 31, 1998	434

/s/ Mary Ann Cohen
Judge

Entered: MAR 10 2003

V. PERTINENT PORTIONS OF RELEVANT STATUTES:

A. Title 26 U.S.C. Sec. 1366(b):

(b) CHARACTER PASSED THRU.__The character any item included in a shareholder's pro rata share under paragraph (1) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the corporation [S corporation], or incurred in the same manner as incurred by the corporation [S corp.].

B. Title 26 U.S.C. Sec. 3121(d):

(d) EMPLOYEE.—For purposes of this chapter, the term employee means—

(1) any officer of a corporation; or

(2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or

(3) any individual (other than an individual who is an employee under paragraph (1) or (2) who performs services for remuneration for any person—...

If the contract or service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term "employee" under the provisions of this paragraph if such individual has a substantial investment in facilities used in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction not part of a continuing relationship with the person for whom the services are performed..."

C. Relevant excerpts from Section 530 of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (amended by Act of Dec. 29, 1979, Pub. L. No. 96-167, 93 Stat. 1275; Act of Dec. 17, 1980, Pub. L. No. 96-541, 94 Stat. 3204; Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324; Tax Reform Act of 1986, Pub. L. No. 95-514, 100 Stat. 2085; and Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755)

Act Sec. 530(a) TERMINATION OF CERTAIN EMPLOYMENT TAX LIABILITY.—
(1) IN GENERAL.—If—

(A) For purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and

(B) In the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

(2) STATUTORY STANDARDS PROVIDING ONE METHOD OF SATISFYING THE REQUIREMENTS OF PARAGRAPH (1).—For purposes of paragraph (1), a taxpeyer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

(A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;

(B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged..."

Act Sec. 530(b) PROHIBITION AGAINST REGULATIONS AND RULINGS OF EMPLOYMENT STATUS.—No regulation or Revenue Ruling shall be published on or after the date of the enactment of this Act and before the effective date of any law hereafter enacted clarifying the employment status of individuals for purposes of the employment taxes by the Department of the Treasury (including the Internal Revenue Service) with respect to the employment status on any individual for purposes of the employment taxse.

Act Sec. 530(c) DEFINITIONS.—For purposes of this section—

(1) EMPLOYMENT TAX.—The term "employment tax" means any tax imposed by Subtitle C of the Internal Revenue Code of 1954.

(2) EMPLOYMENT STATUS.—The term "employment status" means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an employee).

Act Sec. 530(e) SPECIAL RULES FOR APPLICATION OF SECTION.—

(1) NOTICE OF AVAILABILITY OF SECTION.—An officer or employee of the Internal Revenue Service shall, before or at the commencement of any audit inquiry relating to the employment status of one or more individuals who perform

services for the taxpayer, provide the taxpayer with a written notice of the provisions of this section..."

(4) BURDEN OF PROOF.—

(A) IN GENERAL.—If—

a taxpayer establishes a prima facie case that it was reasonable not to treat an individual as an employee for purposes of this section, and

the taxpayer has fully cooperated with reasonable requests from the Secretary of the Secretary of the Treasury or his delegate,

then the burden of proof with respect to such treatment shall be on the Secretary.

(B) EXCEPTION FOR OTHER REASONABLE BASIS.—In the case of any issue involving whether the taxpayer had a reasonable basis not to treat an individual as an employee for purposes of this section, subparagraph (A) shall only apply for purposes of determining whether the taxpayer meets the requirements of subparagraph (A), (B), or (C) of subsection (a)(2).

VI. OTHER AUTHORITIES:

A. **Explanation of Provisions"** portion of Congressional intent of application of Section 530 of the Rev. Act of 1978 as found in H.R. Rep. No. 95-1748, 95th Cong., 2d Ses. 5 (1978) 1978-3 (Vol. 1) C.B. 631 - 633:

Explanation of Provisions

The bill provides an interim solution for controversies between the Internal Revenue Service and taxpayers involving whether certain individuals are employees under interpretations of the common law b—

(1) terminarting certain employment tax liabilities for periods ending before January 1, 1979,

(2) allowing taxpayers, who had a reasonable basis for not treating workers as employees in the past .to continue such treatment without incurring employment tax liabilities for periods ending before January 1, 1980, while the committee works on a comprehensive solution, and

(3) prohibiting the issuance of Treasury regulations and Revenue Rulings on common law employment status before 1980...

Generally, the bill grants relief if the taxpayer had any reasonable basis for treating workers as other than employees. The committee intends that this reasonable basi requirement be construed liberally in favor of taxpayers...

...The three statutory methods for fulfilling the requirement that a taxpayer had a reasonable basis for the treatment of an individual as other than an employee

are not the exclusive ways of meeting the bill's reasonable basis requirement. A taxpayer who can demonstrate a reasonable basis for the treatment of an individual in some other manner also is entitled to termination of employment tax liabilities...

B. Definition of "or" from **Webster's Third International Dictionary of the English Language Unabridged**, p. 1585 (1993 Ed.):

"...the synonymous, equivalent, or substitutive character of two words or phrases [fell over a precipice or cliff]; [the off or far side][lessen or abate]; correction or greater exactness of phrasing or meaning [these essays, or rather rough sketches][the present king had no children—or no legitimate children]."

C. Non-legislative Federal labor regulation defintion of "employees" as found in 29 C.F.R. Sec. 2510.3-3(c)(1):

(c) Employees. For purposes of this section:

(1) An individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual and his or her spouse...